Hearing on How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs

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HEARING

BEFORE THE

SUBCOMMITTEE ON TAX POLICY

OF THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTEENTH CONGRESS

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Hearing on How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs

U.S. House of Representatives,
Subcommittee on Tax Policy,
Committee on Ways and Means,
Washington, D.C

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WAYS AND MEANS
CHAIRMAN KEVIN BRADY

Tax Policy Subcommittee Chairman Roskam Announces Hearing on How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs

House Committee on Ways and Means Tax Policy Subcommittee Chairman Peter J. Roskam (R-IL) announced today that the Subcommittee will hold a hearing on how tax reform will enhance the contribution that small businesses make to the growth of the American economy and the creation of jobs for American workers. **The hearing will take place on Thursday, July 13, 2017 in 1100 Longworth House Office Building, beginning at 10:00 AM.**

In view of the limited time to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, http://waysandmeans.house.gov, select "Hearings." Select the hearing for which you would like to make a submission, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Thursday, July 27, 2017.** For questions, or if you encounter technical problems, please call (202) 225-3625.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the

Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.

Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available at http://www.waysandmeans.house.gov/

HOW TAX REFORM WILL HELP AMERICA'S SMALL BUSINESSES GROW AND CREATE NEW JOBS

Thursday, July 13, 2017

House of Representatives,

Subcommittee on Tax Policy,

Committee on Ways and Means,

Washington, D.C.

The subcommittee met, pursuant to call, at 10:01 a.m., in Room 1100, Longworth House Office Building, Hon. Peter J. Roskam [chairman of the subcommittee] presiding.

Chairman Roskam. The subcommittee will come to order.

Welcome to the Ways and Means Subcommittee on Tax Policy. Our hearing is How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs.

You know, one of the things that makes Americans really charming and delightful, in my view, is that we are not a jealous people. And if you think about it, it is cooked deeply into our DNA. When we see our neighbors succeed, we say, how nice for you. That is because we know that with hard work that could be us or that could be our children or our grandchildren. Unfortunately, this basic premise of the American dream, that anyone with a good idea and hard work can start a successful business, is under attack in part, not in all, but in part, From an antiquated and A bloated Tax Code. In 1913, when the Federal Tax Code was created, it was 400 pages long. And today it is 74,000 pages. Need I say more?

Imagine that you are starting off a small business that you have always dreamed of. First off, as a pass-through entity, you should know that the IRS is planning to take 44.6 percent of your business income if you are a success. That is less money for you to grow your business and it is less money for you to hire workers with.

Next, you will have to navigate through a mesmerizing array of depreciation schedules. The desk that you work at, well, you can depreciate that over 7 years but the computer takes 5. And although the sidewalk you needed to build on customers, that will take 15. But don't worry, though, the tree that shades the sidewalk is also on that same 15-year depreciation schedule, unless it creates fruit that you sell, and then that is 10 years. After you have figured everything out, you start turning a profit, remember not to use all your deductions right away because you will need to calculate your regular tax liability, and then you do it again by calculating your alternative minimum tax, the AMT. And, of course, you will be paying whichever of those is higher.

And, finally, if you found a way to overcome all the obstacles that the Tax Code threw at you, you are going to start an estate plan right away. Because you if want to leave the business to your children when you pass on, the government will be taking an additional 40 percent out of your business assets upon your death. And if that sounds ridiculous, because it is.

Now, there is good news. This Tax Code is not a natural disaster. This is not Hurricane Katrina. This is not an event that we can't avoid. In fact, it is a problem that was created by law, and it can be changed just as simply by law. And in the Ways and Means Committee, we are proposing a simplified Tax Code that works with, instead of against, small business.

First, we are proposing to drop the rate from 44.6 to 25 percent. This means more money to hire employees, and it means more money to grow a business. Then we simplified the Tax Code in three main ways. We eliminate the nonsensical depreciation schedules and replace them with immediate expensing. So, when you buy equipment for your business, you write it off, all of it, that year. Then we eliminate the AMT so that businesses can know exactly what they owe without having to worry about a second hidden Tax Code. And, finally, we abolish the death tax so that families are never forced again to find a way to pay a 40 percent tax on their business, or worse yet sell it off to pay the tax.

Clearly, tax reform is not a simple task. It is not for the faint of heart, and there are questions that still remain. The Ways and Means Committee has been hard at work trying to figure out the fairest way to define business income, for example, so that companies are taxed fairly. Additionally, as many small businesses already take advantage of immediate expensing through Section 179, the committee is developing rules to allow small businesses to continue to deduct their interest payments on business-related debt.

With this in mind, I am pleased to welcome our witnesses, and I look forward to hearing from all four of you this morning. And I know I speak on behalf of the entire subcommittee when we say thank you for your time.

We are interested in trying to create the best Tax Code that we can members on both side of the aisle. And toward that end, I now yield to the distinguished ranking member from Texas, Mr. Doggett, for the purpose of an opening statement.

Mr. Doggett. Thank you, so much, Mr. Chairman. It is very good that we can finally hold the inaugural meeting of this subcommittee under your leadership. I thank you for responding to my letter requesting that the subcommittee actually do something this year, and I would ask unanimous consent to make that letter requesting hearings a part of the of record.

Chairman Roskam. Without objection, so ordered.

Pending Insert Submission

Mr. Doggett. I know you plan to hold an additional hearing next week, a final hearing before the August recess concerning individual tax, which is good. But there are a number of additional topics that are included in that letter that deserve this subcommittee's thorough evaluation, and I hope we can do that as well.

More than one full year after the announcement of the Republican self-styled Better Way tax blueprint, it is rather late that we convene, if the true goal is to enact genuine comprehensive tax reform during the few legislative days that remain in the waning months of this year. We do have agreement that small business is a good place for this committee to begin in this first hearing. Because so often the Congress has riddled in the many pages of the Tax Code to which you refer, has riddled that Tax Code with provisions that reward the giant enterprises that regularly fill this very room with lobbyists. And it often neglects the small businesses whose owners are usually too busy to even come to Washington because they are trying to make a go of their business.

These are the businesses that I represent. They don't have offshore accounts. They don't have foreign subsidiaries. And they aren't concerned about whether they will renounce their American citizenship. I believe we should be taking a close look at the preferences, the schemes, the shenanigans, that are used to shift the tax burden to small businesses and individuals while many large multi-nationals, on some of their income, through earning stripping, don't pay any taxes or next to nothing.

I believe that we should be seeking common, bipartisan ground behind genuine tax reform that is designed to encourage entrepreneurship, support small businesses, and grow jobs here in America.

I represent a part of Texas in which small business is vital. It is the part of Texas that doesn't consider having a taco truck on every corner a political insult as intended but rather a practical convenience. It is a place where we have many valued traditional small businesses, restaurants, tire shops, construction contractors. But also, in both Austin and San Antonio, we have a growing number of incubators, and accelerators, places like Capital Factory and Geekdom with a wide range of high-tech startups that are creating our economic future right now.

As we look at how to encourage the advancement of these very type of small businesses, I think it is important to abide by certain principles. The first of these is that we not finance a tax cut by borrowing from abroad, by asking the

Chinese and the Saudis to finance our tax cut. We know that there are mystical, mythological statements that are made about how all these tax cuts will pay for themselves. They are just never borne out by history. And they are not even borne out by the Republican economists like Douglas Holtz-Eakin who have testified before this committee.

Second, I think it is important to not tilt the playing field even further to advantage some businesses over others. We should avoid picking winners and losers, more tax breaks for the large, profitable, multi-nationals that already pay, at times, only single digits doesn't help small businesses. It is basically just not fair when Pfizer, with its 181 subsidiaries and tax havens pays a lower tax rate than Davila Pharmacy that I represent on the west side of San Antonio.

Finally, I think in tax reform it is important that we not widen the growing income gap in this country. And in that regard, as we look at the specifics of today's hearing, we do want parity for all businesses. But we don't want to create new loopholes. Not all those that benefit from pass-throughs are genuinely small businesses. Many of them are connected to Wall Street, to some of the wealthiest people in the country. They provide opportunities for even Donald Trump to pay less taxes, if that is possible. And so we need to look carefully at the proposals that the Republicans are advancing to ensure they accomplish the objective that we share of advancing small business.

And I thank you, Mr. Chairman.

Chairman Roskam. Thank you, Mr. Doggett. You know, on these points that you made, not borrowing from abroad, don't tilt the playing field, and don't widen the income gap, I think there is a lot of interest on both sides of the aisle. And I think, in particular, we are going to hear today from witnesses who can tell us their own journeys as it relates to entrepreneurship, barriers to entry, and so forth.

So let's let the show begin. Today's panel includes four experts. Theresa Meares is president of DGG Uniform and Work Apparel.

I would like to yield to the gentlelady from South Dakota to introduce our next witness.

Mrs. Noem. Well, thank you, Mr. Chairman. And I would like to introduce Mr. Scott VanderWal today who will be testifying. He is from the great, and wonderful, and beautiful State of South Dakota. So we are thrilled that he is here. Scott is a third generation family farmer in the State of South Dakota who lives just down the road from me. It is actually about 30 miles away, but in South Dakota that is still neighbors.

For us, Scott has been a real leader on a lot of issues. He is the President of the South Dakota Farm Bureau. He is Vice President of the American Farm Bureau Federation, and he also works with his dad, his uncle, and his son in his family operation.

Mr. Chairman, we all eat, and we pay taxes, in one form or another. And as we dig further into the problems that the Tax Code presents for all of us, and that Tax Code that we live under, Scott is here to give us a perspective of someone who grows what we all eat. And so thank you for joining us today, Scott, and I really look forward to your testimony.

I yield back, Mr. Chairman.

Chairman Roskam. Thank you, Mrs. Noem.

Next, Rebecca Boenigk is Chief Executive Officer of Neutral Posture. And, finally, Chye-Ching Huang is Deputy Director of Federal Tax Policy at the Center on Budget and Policy Priorities.

The committee has received your written statements, and they are all made part of the formal hearing record. You each have five minutes for your oral remarks.

Let's begin with you, Ms. Meares.

STATEMENT OF TERESA MEARES, PRESIDENT, DGG UNIFORM AND WORK APPAREL

Ms. Meares. Thank you, Chairman Roskam, and Ranking Member Doggett, and all the members of the committee on Ways and Means Subcommittee on Tax Policy for hosting this hearing.

My name is Teresa Meares. And it is my honor to be here with you today to share my experiences. I am a small business owner two times over, the mother of a 13-year-old small business owner, and on July 1st I completed my year tenure as the chair for NAWBO, the National Association of Women Business Owners, where we represent the 10-plus million women businesses in this country. NAWBO was founded in 1975 to be the first advocacy organization for all women business owners, and we are proud to represent one of the fastest growing segments of the economy today.

My company, DGG Uniform and Work Apparel, is a growing company where in the last six months I have hired five new employees. Before I get into details of my current company and my experience as the chair for NAWBO, let me give you a little bit of history about me and my business experience.

As I am a retired law enforcement from Florida, where I spent 20 years serving my community. In 2006, I bought an exclusive distributorship for certain law enforcement products. I obtained the capital through an SBA 7(a) loan, and I purchased two business condos with an SBA 504 loan. My husband and I used our retirement for the down payment and for capital to build our company. We quickly grew our company, and when we expanded our product line in 2007, we had made over a million dollars in revenue within the first year. We went from one employee to 28 in 2 years. And then within 5 years we had grown our revenue to over $15 million.

We were pleased with the expansion, but the initial capital of our retirement was in no way to support our immediate and rapid growth. We had already had the SBA loans to start, so cash was hard to come by, and we had to try to self-fund our capital needs. We survived, but it was not easy.

Last year, I was fortunate enough to sell that company, and then I launched a uniform and clothing line. We, again, have experienced fast growth. And although I am determined to develop this company at a more controlled pace, I need to have the ability to support this long-term. Tax reform focused on allowing small businesses to keep more cash is the place to started.

As I cultivate this business, some things that affected me with my previous venture are on my mind. The complicated nature of the Tax Code led to misunderstandings and confusion. For example, the ability to use or not to use certain deductions in order to generate cash back into my company. As a result, I overpaid taxes during those critical years when I needed cash flow to support my growth. I survived these challenges with my previous business, but now I find myself in a very similar place. The challenges I faced then are very much looming in front of me. And I want the tax to be reasonable where I can capitalize for my business. And I want to support this great country at the same time.

With my current projections a 10 percent reduction in the tax rate alone in the next two years would allow me to save $10,500 on the first year, and then

$50,000 in the second year. This will allow me to reinvest back into my company. And within the fourth year, I would end up paying a higher tax at a lower rate due to my higher net margins instead of a lower tax at a higher rate due to the net margins from the lack of growth.

Small businesses are the backbone of America. And we are the ones that generate new employment numbers and stimulate our economy. And, as such, we should also be the focus when discussing how to best reform the Tax Code.

I spent the last year traveling nationally and internationally as the NAWBO chair to meet with small, women-owned businesses. And here are some of the discussions that are occurring: Lower taxes. Small businesses need to have a lower tax rate so we can focus on investing in our companies. We work hard and long hours. And we are usually the first one to sacrifice when cuts need to be made. Many small business owners pay everyone and everything first and then they look to see what is left at the end.

The NAWBO 2017 membership survey revealed that more than a third of women business owners who responded work between 40 to 49 hours a week, more than half have carried business costs on a personal credit card, and nearly one-third have never given themselves a raise. Lowering taxes and incentivizing small business ownership can create jobs and support the continued growth of small businesses. Those of us who have to purchase equipment to run and support our productions within our business need to utilize the use of fully writing off this expense. Not having the benefit to write off the full cost of the machinery on top of paying a higher tax is definitely going to slow our growth.

Women are resourceful. But, as statistics have told us, more risk adverse. Imagine what power and growth we could unleash if they had a little more faith and believed that they would not crumble under the challenges faced by companies who grow and add employees. Having a Tax Code that focuses on lower and straightforward tax laws would benefit and reward them instead of scaring them away.

Thank you again for hosting this hearing and encouraging this conversation.

WRITTEN TESTIMONY OF TERESA MEARES
HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TAX POLICY
HEARING ON HOW TAX POLICY WILL HELP AMERICA'S SMALL BUSINESSES GROW AND CREATE NEW JOBS
THURSDAY, JULY 13, 2017

Thank you Chairman Roskam, Ranking Member Doggett and all the Members of the Committee on Ways and Means Subcommittee on Tax Policy for hosting this hearing on such an important topic and one very close to my heart - How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs. It is an honor to appear before you today.

My name is Teresa Meares. It is my pleasure to be here with you today to share my experiences. I am a small business owner two times over, the mother of a 13 year old small business owner and on July 1, I completed my year-long tenure as Chair of NAWBO, the National Association of Women Business Owners, where we are proud to represent the 10+ million women owned businesses in this country. NAWBO was founded in 1975 to serve as the first advocacy organization for all women business owners. Today we are proud to continue that legacy and represent one of the fastest growing segments of the economy, women business owners. NAWBO is the only dues-based organization representing the interests of all women entrepreneurs across all industries; and with chapters across the country. With far-reaching clout and impact, NAWBO is a one-stop resource to propelling women business owners into greater economic, social and political spheres of power worldwide.

My company, DGG Uniform and Work Apparel, is a growing company where in the last 6 months I have hired 5 new employees, 2 of whom are Veterans, 2 of whom were unemployed, and 1 of whom was about to be unemployed. We operate as an LLC and file as an S-Corp.

Before I get into the details of my current company and experience as the Chair for NAWBO, please allow me to provide you with a little history on myself and my business experience. I am a retired law enforcement officer from Florida, where I spent 20 years serving my community. In 2006, I bought an exclusive distributorship for certain law enforcement products. I obtained the capital through an SBA 7a loan and I purchased two business condos with an SBA 504 loan. My husband and I used our retirement savings for the down payment and for capital to grow our company.

We quickly grew our company and when we expanded our product line in 2007, we made over a million dollars in revenue within the first year. We went from 1 employee to 28 within 2 years and within 5 years we had grown our revenue to more than 15 million dollars. While we were pleased to see the company expand, the initial capital of our retirement was in no way enough to support our immediate and rapid growth. We already had the SBA loans to start so cash was hard to come by and we had to try and self-fund our growth. We survived, but it was not easy.

Last year I was fortunate enough to sell that company and I launched a uniform and clothing line. We again have experienced fast growth and although I am determined to apply the lessons from the last ten years and not repeat them and grow at a more controlled pace, I need to have the ability to support this growth. Tax reform focused on allowing small businesses to keep more cash in our companies is a place to start.

As I grow this business some things that affected me with my previous venture are on my mind. There were road blocks that took cash out of my business, hurt my cash flow and stunted my growth.

The complicated nature of the tax code led to misunderstandings and confusion. I lacked the ability to understand or use certain deductions in order to generate cash back into my company. As a result, I overpaid in taxes during those critical years when I needed cash flow to support the growth in my company. When I finally stopped and questioned why I had no cash, while having to pay so much back out, I had to spend $20,000 in legal and CPA fees to understand if I could or could not use certain items as a tax deduction. As a small business owner, I do not have the resources for expensive tax attorneys to guide me each year or the ability to have multiple CPAs review and give second opinions. Yes, I was able to go back and correct these incorrect filings, but the time, effort, energy and loss of the ability to use the capital when I needed it most had already passed.

I survived these challenges with my previous business. But I now find myself in the same place - growing a small business. The challenges I faced the first time are still very much looming in front of me. I still utilize my tax attorney and I have a new CPA, but I worry and become concerned because I will need cash and capital to grow my business, as I did before, but I also know there are many road blocks with the current tax structure that will hold me up or cause me to spend extra money to research how I best can keep that cash to support my growth. I want the tax to be reasonable to where I can capitalize for my business and support this awesome country I live in at the same time.

Small businesses are the back bone of the American economy and we are the ones who grow the employment numbers and stimulate our economy. As such, we should also be the focus when discussing how to best reform the tax code. I have read and watched several statements on the current thought process on tax reform and I think one thing that everyone agrees on is that there is a need for tax reform and the focus and discussion is on how.

Like so many small humble business owners, I am just trying to make a living, support my family and provide good employment to people wanting a career and not just a job. I think my money can be best spent supporting and growing my business. Having a simplified tax code that benefits small businesses instead of creating a disparity of penalization that occurs because we cannot afford a host of tax attorneys to save us as much money as possible so we can support our growth, is the key to helping small businesses scale their growth and not fail due to their growth.

So as a mother to a 13-year-old business owner, small business owner two times over, who spent the last year traveling nationally and internationally as the NAWBO Chair to meet with small women owned businesses, here are the lessons I learned and tax reform issues that were part of nearly every discussion I had.

Lower Taxes; Small businesses need to have a lower rate of tax so we can focus on investing in our companies. I have yet to meet an extremely wealthy small business owner. We make a living, but we are not sailing around on yachts. We work hard and long hours and are usually the first one to sacrifice when cuts need to be made. Many small business owners pay everyone and everything first and look to see what is left in the end. Lowering taxes and incentivizing small business ownership can increase jobs and support the continued growth of small businesses.

With my current projections, a 10% reduction alone over the next two years would allow me to contribute $10,500 in the first year and then $50,000 in the second year. This will allow for me to reinvest in my company, and within the 4th year end up paying a higher tax at a lower rate due to higher net margins allowed by growth; instead of a lower tax at a higher rate due to reduced net margins from the lack of growth in revenue. Those of us who have to purchase equipment to run or support the production within our business need to be able to fully write this expense off. As I continue to grow my company, I have to add embroidery machines, sewing machines, heath-press machines, and silk-screening machines. As you can imagine growing this business and needing additional machinery to do so can become costly. Not having the benefit of writing off the full cost of the machinery on top of paying a 35-40% tax rate would stunt our growth.

Death Tax; As our company grew, my husband and I paid thousands of dollars a year for insurance to cover any outstanding business loans and personal loans. We thought it would also leave enough to temporarily support our children, 3 of whom at the time were underage and one was in college.

Then as our revenue and company grew we learned that if anything had happened to both my husband and I, our children would have a large tax bill due based on their inheritance of the company and any assets. My children sacrificed a lot, if not just as much as my husband and I, as we grew the company in the early stages. To think they would be taxed and penalized because they were not the “owners” at the time really upset me. Due to my husband and I being partners and traveling together a lot, the possibility of something happening to both of us at the same time was a real concern. We had to pay attorney fees to create a trust and we had to get another insurance plan to cover any tax bill they would be left with.

I can remember days where the two younger ones, 3 and 7, would come to the shop and we would pop up tents and setup the DVD player to play Disney movies as my husband and I worked. They would also jump in and help just as much. The days they were staying at family and friends when my husband and I traveled to conference and shows selling our product. Yes! They definitely gave and sacrificed a lot for us to have what we have in a small business today.

So while we were a growing business strapped for cash to grow, paying a high tax rate (without our known deductions), paying attorney and CPA fees, we also had to spend thousands of dollars to create trust, living wills, and another “survivorship” insurance plan so our family and business would not be left with the burdens that would have been created. So, there is another $5,000 dollars a year I could save and put back into my company. A total of $15,000 the year we had to create the trust.

What I have just described is reality for 90+% of small business owners. When I am a passenger in a car and can just ride along and look out the window, I am amazed at all of the small businesses in just my state of Florida alone. Each of those in strip malls or business parks represent a business owner employing at least 1 person, but on average 4 to 5. Then you have those who have a homebased business, that also provide employment to others who work from their home. We have several NAWBO members who are home based, but have employees or contractors and they are working toward growing and expanding their business. Having tax reform that supports more capital to grow their business and incentive it to grow would lift the barriers and load that may be holding them back.

Women are resourceful, but as statistics have told us, more risk adverse. Imagine what power and growth we could unleash if they had a little more faith and believed that they would not crumble under the challenge faced by companies who grow and add employees. Having a simplified tax code that focuses on lower and straightforward tax laws would benefit and reward small business owners instead of scaring them away and penalizing those who cannot afford to hire a tax attorney/advisor. And studies have also shown women always give back into their community with human and monetary capital. Saving them money will help them grow and they will give back.

According to a 2016 Wall Street Journal article, women are more likely to give charitably, and to give more, than men in similar situations. Research at the Women's Philanthropy Institute at the Indiana University Lilly Family School of Philanthropy has found consistently that women and men give differently. In one study, baby boomer and older women gave 89 percent more to charity than men their age, and women in the top 25 percent of permanent income gave 156 percent more than men in that same category.

I see that give back attitude within the membership of NAWBO. We believe the diversity of our membership – representing women business owners of all sizes, in all stages of business development and all sectors of the economy – gives us strength. We have within our membership women business owners of various structures – LLCs, S-corps, sole-proprietorships and non-profits. This allows us to see firsthand how important comprehensive tax reform will be for this nation's women business owners and as such for the economy as a whole.

Our 2017 membership survey reveals that the majority of respondents cited taxes and regulations (52.52%) as the top advocacy issues impacting their business.

The survey also reveals that more than a third (35.33%) of women business owners who responded work between 40-49 hours a week, more than half (53.43%) have carried business costs on a personal credit card and nearly one third (32.29%) have never given themselves a raise.

Again, I have to ask us all to imagine what the economy could look like if these women business owners and all small business owners, who pay themselves last, who carry business debt on personal credit cards and who want to grow so they can give back to their communities and our country would look like if they had a lower tax rate and a simpler tax code to comply with. Wouldn't this ultimately allow them to keep more of their hard earned dollars? And don't we all believe they would take those dollars and reinvest them in the businesses they love?

Chairman Roskam. Thank you, Ms. Meares.

Mr. VanderWal.

STATEMENT OF SCOTT E. VANDERWAL, OWNER VANDERWAL FARMS

Mr. VanderWal. Chairman Roskam --

Chairman Roskam. Turn on the mike, would you?

Mr. VanderWal. I am sorry. Apologize for that.

Chairman Roskam, Ranking Member Doggett, and members of the subcommittee, thank you, so much, for holding this hearing about tax reform and small business this morning.

I appreciate the opportunity to speak to you about the importance of tax reform in our farm and ranch business. My name is Scott VanderWal, and I, along with my father, my uncle and son, operate VanderWal Farms in Volga, South Dakota. We farm 1300 acres of corn and soybeans. We operate a beef cattle feed lot where cattle are prepared for market, and harvest crops for neighbors and neighboring farmers.

While Representative Noem mentioned that I am the third generation in our farm, I would like you to know that my son is the fourth, and he and his wife had a baby girl back in November who we certainly hope has a chance to farm, if she chooses, when she grows up. So that is certainly an important thing to us.

Before I discuss tax reform, I would like to emphasize the importance of agriculture to our Nation's economy and talk about our business environment. Collectively, agriculture, food and related industries contributed $992 billion to U.S. domestic gross product in 2015. Agriculture and its related industries provide about 11 percent of U.S. employment.

The vast majority of farms are family owned and share several things, including that they operate in a world of uncertainty, from unpredictable commodity and product markets to fluctuating input prices, from uncontrollable weather, to insect or disease outbreaks, running a farm or ranch business is challenging under the best of circumstances.

Farmers and ranchers operate under tight profit margins often for rates of return that are modest compared to other businesses. Our businesses are also cyclical where a period of prosperity can be followed by one or more unprofitable years. We are now in a serious economic downturn with net farm income falling by nearly half since 2011. Farmers and ranchers need permanent tax reform that recognizes the financial challenges we face. We need tax policies that support high risk, high input, capital-intensive businesses. We need a Tax Code that allows us to match income with expenses and helps us to even out high and low income years.

Reducing effective tax rates is the most important thing that tax reform can do to boost farm and ranch businesses. Every dollar that we pay in taxes is a dollar that could be reinvested back into our farm. Any investment we make will not only be good for our farm business, but will lift our communities, and contribute to a robust ag economy.

While lower tax rates are important, the critical measure of any tax reform plan for farmers and ranchers will be the effective tax rates that we pay. Because profit margins in farming and ranching are tight right now, we are more likely to fall into lower tax brackets. But tax reform plans that fail to factor in the impact of lost deductions, credits and exemptions for all rate brackets could result in a tax increase for agriculture and for businesses in general.

Because farms, including ours, have high production input costs, it is especially helpful to be able to immediately write off the cost of equipment and production supplies. With the price of a large combine and a couple of headers topping well over a half million dollars, it is easy to appreciate how expensing helps our farm business to cash flow.

Immediate expensing frees up cash so that we can upgrade equipment, increase livestock, buy production supplies for next season, and expand our businesses, or, probably most importantly, hire farm workers and provide employment. That service is an ongoing and significant cost to doing business for the vast majority of farmers and ranchers, who like my family, depend on borrowing to buy property, equipment, and production inputs. If my family can't deduct interest, it will make it more expensive for our farm to borrow or could restrict the amount we can borrow.

During the difficult economic times we now face, the ability to borrow money is more critical than ever. I also worry about beginning farmers like my son who rely more heavily on debt financing than we do. I know from talking to other farmers and ranchers across the country just how worried they are that their businesses will die with them because of estate taxes. For farms and ranches like ours that are currently under the estate tax exemption, the repeal of stepped-up basis would create new and substantial capital gains taxes. While lower capital gains rates encourage investment, the tax can still discourage property transfers. As my family plans for transfer of our farm from one generation to the next, we are struggling with the impact that capital gains taxes are having on the transfer of that business property.

Lastly, I would like to mention that cash accounting gives farmers the ability we need to plan for major business investments, and in many cases provides guaranteed availability of some ag inputs. Also, like-kind exchanges, or 1031s, help farmers and ranchers buy land and upgrade business assets.

I would like to thank you, again, for the opportunity to visit with you today about the importance of tax reform and how it will help America's small businesses, including farms and ranches, to grow and create jobs.

And I would be happy to answer your questions. Thank you.

STATEMENT OF
Scott VanderWal
VanderWal Farms, Volga, South Dakota

For the Hearing
HOW TAX REFORM WILL HELP AMERICA'S SMALL BUSINESS GROW AND CREATE JOBS

United States House of Representatives
Committee on Ways and Means
Subcommittee on Tax Policy

JULY 13, 2017

Chairman Roskam, Ranking Member Doggett and members of the Subcommittee for Tax Policy, thank you for scheduling this hearing about how tax reform will help America's small businesses to grow and create jobs. I appreciate this opportunity to speak about the need for tax reform and to highlight the tax code provisions important to the long-term financial success of farm and ranch businesses.

My name is Scott VanderWal and I along with my father, uncle and son operate VanderWal Farms in Volga, South Dakota. Our family farming business was started in the 1940s by my grandfather on about 300 acres of land. Today we farm 1300 acres of corn and soybeans, operate a feedlot where cattle are prepared for market and harvest crops for neighboring farmers. While farming is my occupation, I also serve as Vice President of the American Farm Bureau Federation and as President of the South Dakota Farm Bureau Federation.

Most farms in the U.S. are family owned and operated. According to USDA, family farms comprise 99 percent of all U.S. farms and account for 89 percent of production. While our farm is typical for South Dakota, agriculture operations across America vary greatly in the commodities they produce, their size, their reliance on labor, and by the length of their production season. Collectively agriculture, food, and related industries contributed $992 billion to U.S. gross domestic product (GDP) in 2015, a 5.5-percent share. On a value added basis America's farms contributed $136.7 billion of this sum, about 1 percent of GDP. Agriculture and its related industries provide about 11 percent of U.S. employment. Food manufacturing accounts for 14 percent of all U.S. manufacturing employees. U.S. agriculture accounts for 9 percent of total U.S. exports and maintains a positive trade balance year on year.

Even with agriculture's great diversity, all family-owned farms and ranches share several things, including that they operate in a world of uncertainty. From unpredictable commodity and product markets to fluctuating input prices, from uncontrollable weather to insect or disease outbreaks, running a farm or ranch business is challenging under the best of circumstances. In fact, prices of feed grains and feeder cattle, which are central to my business, have fluctuated 53 percent and 85 percent, respectively, over the last decade. Farmers and ranchers need a permanent tax code that recognizes the financial challenges they face.

Another thing that my fellow farmers and ranchers share is that we operate under tight profit margins, often for rates of return that are modest compared to other businesses. This is especially true today as the U.S. farm economy is in the midst of a serious financial downturn. Net farm income has fallen by nearly half, just since 2011. What is needed are tax policies that support high-risk, high-input, capital-intensive businesses like farms and ranches.

Tax reform must be comprehensive and treat farm and ranch businesses that operate as individuals, pass-through businesses and corporations fairly. While our farm functions as a family-owned C-corporation, more than 95 percent of farms and ranches are taxed under IRS provisions affecting individual taxpayers. This is true across all farm sizes – from those earning less than $1,000 in revenues per year, all the way to farms earning more than $5 million. Tax reform that fails to treat sole proprietors, partnerships, S-corporations and C-corporations fairly will not help, and could even hurt, the bulk of agricultural producers who operate outside of the corporate tax code.

Farming and ranching is a cyclical business where a period of prosperity can be followed by one or more years of low prices, poor yields or even a weather disaster. Using our farm as an example, over the last 10 years we have been paid as much as $7.60 a bushel for corn and as little as $2.80. Our yields have ranged from 210 bushels an acre to 160. Tax code provisions such as expensing, bonus depreciation and cash accounting, allow farmers and ranchers to match income with expenses helping them to survive difficult financial times. Provisions that allow agricultural producers to even out their taxable income- for example, like kind exchanges, income averaging and installment sales- allow farmers and ranchers to pay taxes at an effective tax rate equivalent to a business with the same aggregate, but steady revenue stream.

<u>Lower effective tax rates will benefit farm and ranch businesses.</u>

Reducing effective tax rates is the most important thing that tax reform can do to boost farm and ranch businesses. This is especially true during the current downturn in the agriculture economy. Profit margins on our farm have been extremely tight since 2013 forcing us to operate at or below our cost of production. Every dollar that we pay in taxes is a dollar that could be reinvested back into the farm to replace and upgrade our equipment, improve our feedlot, expand our crop production or hire farm workers. Any investment made will not only be good for our farm business but will lift my community and contribute to a robust agricultural economy.

While lower tax rates are important, the critical measure of any tax reform plan for farmers and ranchers will be the effective tax rate paid by farm and ranch businesses. Tax reform that lowers rates by expanding the base should not increase the overall tax burden of farm and ranch businesses. Because profit margins in farming and ranching are tight, farm and ranch businesses are more likely to fall into lower tax brackets. Tax reform plans that fail to factor in the impact of lost deductions, credits and exemptions for all rate brackets could result in a tax increase for agriculture.

<u>Accelerated cost recovery helps farmers and ranchers to be productive and efficient.</u>

Immediate expensing reduces taxes in the purchase year, providing readily available funds for upgrading equipment, to replace livestock, to buy production supplies for the next season and for farmers to expand their businesses. Because farms, including ours, have high production input costs, it is especially helpful to be able to write-off the cost of equipment and production supplies rather than have to depreciate them over time. With the price of a combine topping well over half a million dollars, it is easy to appreciate how much immediate expensing helps our farm business to cash flow. Expanding expensing opportunities will help farm and ranch businesses that have high input costs and sometimes bump up against current expensing limits. Being able to carry deductions forward indefinitely and indexing them for inflation is important to cyclical businesses like farming and ranching with tight profit margins.

<u>Deducting interest expenses is important for financing of farm and ranch investment.</u>

Debt service is an ongoing and significant cost of doing business for farmers and ranchers who, like my family, depend on borrowed money to buy land and buildings, vehicles and equipment, and production inputs. We rely on debt financing because outside investors often aren't interested in low-profit high-risk businesses like agriculture and because family-owned businesses like farming and ranching often aren't interested in having outside investors as business partners.

Interest paid on loans should continue to be deductible because interest is a legitimate business expense. According to the 2012 Census of Agriculture, farmers in my home state of South Dakota, spent more than $209 million on interest expense and averaged more than $21,000 per farm. If my family can't deduct interest it will make it more expensive for our farm business to borrow money or could restrict the amount of money we can borrow. If our farm debt load becomes too great, the long-term viability of our business operation will be called into question.

During the difficult economic times agriculture now faces, the ability to borrow money is more critical than ever. I also worry about beginning farmers like my son who rely even more heavily on debt financing than I do to buy the land, equipment and supplies they need to get started. With the average age of farmers and ranchers at over 58 and rising, availability of capital for new and beginning farmers is more important than ever for the long-term growth of our industry.

<u>Repealing estate taxes will help farm and ranch business to transfer to the next generation of agricultural producers.</u>

My family is actively involved in succession planning, and even though our farm business is currently valued under the estate tax exemption, we often discuss the impact of estate taxes.
I know from talking to other farmers and ranchers from across the country just how worried they are that their business will die with them because of estate taxes. Some farmers worry about estate taxes because of escalated land values that in my area can be as high as $8,000 an acre for

good farmland. Some worry because their businesses have grown to take in sons and daughters or to achieve economies of scale. They spend money on life insurance and estate planning to try to protect their farms and ranches even though these funds would be better spent to upgrade buildings and equipment, upgrade livestock or expand their businesses.

<u>Maintaining stepped-up basis is important to farmers and ranchers.</u>

Repealing the estate tax is important but so is continuation of unlimited stepped-up basis. Some of the land that we farm was purchased for $200 to $400 an acre and is now worth as much as $9,000 an acre. Since our farm is currently under the estate tax exemption, the repeal of stepped up basis would create a new and substantial capital gains tax for family-owned farm and ranch businesses, including ours.

<u>Reducing taxes on capital gains will help farms and ranches to grow and upgrade their businesses.</u>

Capital gains taxes are owed when farm or ranch land, buildings, breeding livestock and timber are sold. While long-term capital gains are taxed at a lower rate than ordinary income to encourage investment and in recognition that long-term investments involve risk, the tax can still discourage property transfers or alternatively lead to a higher asking price. As my family plans for the transition of our farm from one generation to the next, we struggle with the impact that capital gains taxes are having on the transfer of business property. In addition, questions about the deductibility of interest expenses are factoring into our planning. While the impact is significant for established farms and ranches like ours, it is magnified for beginning farmers and ranchers who must purchase and finance the land and equipment that they need to get started in the business.

<u>Cash accounting helps farm and ranch businesses to match income with expenses to improve cash flow.</u>

Cash accounting is the preferred method of accounting for farmers and ranchers because it is simple, it allows them to match income with expenses and it aids in tax planning. Our farm business uses cash accounting. This allows us to improve cash flow by recognizing income when it is received and recording expenses when they are paid. It gives us the flexibility we need to plan for major business investments and in many cases provides guaranteed availability of some agricultural inputs. It also allows us to control the timing of expenses to balance against revenue and target an optimum level of income for tax purposes.

Loss of cash accounting would create a situation where we might have to pay taxes on income before receiving payment for sold commodities. Not only would this create cash flow problems, but it also could necessitate a loan to cover ongoing expenses until payment is received. The use of cash accounting helps to mitigate this challenge by allowing us to make tax payments after we are paid for our commodities.

Like-kind exchanges help agricultural producers to operate successful businesses.

Section 1031 like-kind exchanges help farmers and ranchers operate more profitable businesses by allowing them to defer taxes when they sell business assets and replace them with better land or buildings, more efficient vehicles and equipment and upgraded livestock. Without like-kind exchanges some farmers and ranchers would need to incur debt in order to improve their farm or ranch businesses or, worse yet, delay improvements needed to maintain the financial viability of their farm or ranch. I know farmers and ranchers who were able to continue farming and ranching when they used a like-kind exchange to sell farmland in the path of urban sprawl and move to a different location, sometimes with an expanded operation.

In Summary: Congress, and the Committee on Ways and Means in particular is to be commended for moving forward with comprehensive tax reform designed to spur growth of our nation's economy. Many of the provisions of the committee's tax reform blueprint will be beneficial to farmers, including reduced income tax rates, reduced capital gains taxes, immediate expensing for all business inputs except land and the elimination of the estate tax. The proposed loss of the deduction for business interest expense, however, is a cause for concern. The blueprint can be improved by guaranteeing the continuation of stepped-up basis, preserving cash accounting and maintaining like-kind exchanges. Thank you again for the opportunity to visit with you today about the importance of tax reform and how it will help America's small businesses, including farms and ranches, to grow and create jobs.

Chairman Roskam. Thank you, Mr. VanderWal.

Ms. Boenigk.

STATEMENT OF REBECCA BOENIGK, CHIEF EXECUTIVE OFFICER, NEUTRAL POSTURE

Ms. Boenigk. Good morning, Mr. Chairman, and members of the committee. My name is Rebecca Boenigk. I am the CEO of Neutral Posture. And in 1989 my mother and I started our business together. I am here today representing myself, my family, my employees, and my business.

When we started the company out of my garage, we raised money to get started. We worked hard, and we developed an office chair based on my dad's expertise in ergonomics. Two years later, as our business was gaining steam, we discovered an unwelcome surprise. We got a call from our accountant who said we owed $86,000 in taxes. It wasn't because of ill intent. It was just because the Tax Code was very confusing, and we didn't understand that we couldn't write off inventory as an expense. We figured we had paid for it, so it must be an expense. But that is not the way the system works. It has to count as an asset instead. So that cost us $86,000 in taxes that we weren't planning on paying at that time. Fortunately, we were able to expand quickly enough to recover the unexpected cost. Other small startups are not as lucky.

Almost 30 years later, we have 130 people, including almost 90 at our factory in Texas, and 60 representatives across the U.S., Canada, and Puerto Rico. About a third of our income comes from the chair that my father developed, the Neutral Posture series, which is a high-end, task-intensive ergonomic chair. These chairs are the most comfortable chairs in the world, and are probably a little more comfortable than the ones that you are sitting in now.

For a small manufacturer like us, it is clear our Tax Code has been broken for many years. We are due for an overhaul, one that closely resembles the plan that has been laid out by this committee. If Washington is serious about strengthening the American economy, it is time to enact a plan that will level the playing field for all American businesses by encouraging investment and job creation. Piecemeal efforts won't get us there, won't get us what we need. We need comprehensive and permanent tax reform, and we need it now.

It begins with treating small businesses the same as we do large corporations or at least getting as close to parity as we can. According to the SBA Office of Advocacy, the 28.8 million small businesses in this country, nearly half of the employer firms are organized as S corporations, and 11 percent are sole proprietorships. Of the ones that are sole proprietorships, 86.4 percent -- I am sorry. Those are the sole proprietorships. All of these companies use the pass-through rate, which is the individual rate.

As with many small businesses, the S corporation taxes have worked pretty well. But there are so many different things that are convoluted about it that it is so difficult to be able to understand the code. For example, my personal tax return is 79 pages long. I have no idea what most of it says. But I have to sign my name to it saying that I agree with everything that is in there. The complexity is coupled with higher taxes.

The 35 percent tax rate that is imposed on corporations is one of the highest in the world. But S corporations like mine pay an even higher rate, 39.6 percent or more. According to the tax foundation on the Federal level, pass-through businesses are subject to the top marginal rate of 44.6 percent. That means in most U.S. States the pass-through rate can exceed 47 percent. So to a small business owner, that is almost 50 percent of every dollar you earn you are turning around and paying in taxes.

A recent study by Women Impacting Public Policy highlighted the fact that women-owned businesses miss out on more than 255 billion in tax incentives because of the industries they are in or the way that they form their corporations. Cutting the corporate tax is badly needed. But rates need to come down for all businesses regardless of how they are organized. The goal should be to allow entrepreneurs to keep more of their earnings so they have the ability to reinvest the profits, increase output, and hire more workers.

We shouldn't stop there. In the furniture industry, we face heavy competition from foreign importers, companies that sell cheaper, less reliable products from companies like China, import those products with a significant tax advantage. Eliminating the foreign goods subsidy and allowing American producers to write off capital investments more quickly would help companies like mine.

Another challenge facing small businesses is the estate tax. If someone happens to claim a significant share of a family-owned small business as an asset, the heir to that asset can potentially be penalized to the point that the company no longer survives. In our case, my mother, my partner, owns

44 percent of the business. If she were to pass away, we would be unable to pay the ensuing taxes. That is right, after you clear all the other hurdles and create a successful business, the estate tax jeopardizes passing it on to future generations. The estate tax amounts to double jeopardy on income and assets that have already been taxed, and it should be eliminated permanently.

In conclusion, I am recommending equal tax treatment for businesses no matter how they are formed, elimination of the estate tax, and simplification of the Tax Code for everyone. And these changes need to be permanent. Small businesses cannot plan for the future with a changing Tax Code.

Mr. Chairman, thank you, again, for bringing this issue to light. We look forward to working with you, and I am happy to answer any questions.

Rebecca Boenigk
Ways & Means Testimony
July, 2017

Good afternoon, Mr. Chairman and members of the Committee. My name is Rebecca Boenigk and I'm the Chairman of the Board and CEO of Neutral Posture, located in the great state of Texas. I am here today on behalf of myself, my family, and my company.

In 1989, my mother and I started a business out of our garage. We raised money to get started, worked hard, and developed an office chair based on my dad's expertise in ergonomics. Two years later, as our business was gaining steam, we discovered an unwelcome surprise. We owed an additional $86,000 in taxes on top of what we had already paid.

It wasn't because of ill intent or carelessness. It was because our complex, outdated tax code appears engineered to prevent small businesses from starting and growing here in the United States. In our case, the tax bill was a penalty for taking the necessary steps to make our company successful. Instead of counting inventory as a deductible investment in our business, it was instead considered a taxable asset. We assumed that because we had spent the money to buy the inventory that it was expensed. Lesson learned, at a cost of $86,000.

Fortunately, we were able to expand quickly enough to cover those unexpected costs. Other small start-ups are not that lucky. Almost 30 years later, we have 130 workers, including 90 at our headquarters in Bryan, Texas, and another 60 representatives across the U.S., Canada, and Puerto Rico.

A third of our revenue comes from the Neutral Posture Series, which is the high end, task intensive ergonomic seating line. The chairs have contoured seats, which help reduce seated pressure. We have an inflatable air lumbar in the back rest. Our chairs have been proven to reduce injuries and to reduce workers' compensation costs. I believe we manufacture the best office furniture on the market.

For a small manufacturer like us, it's clear our tax code has been broken for decades. We're due for an overhaul – one that closely resembles the plan laid out by this committee.

If Washington is serious about strengthening the American economy, it is time to enact a plan that will level the playing field for American businesses by encouraging investments and job creation. Piecemeal efforts won't get us where we need to go. We need comprehensive, permanent tax reform, and we need it now.

It begins with treating small businesses the same as we do large corporations. According to the SBA Office of Advocacy, of the 28.8 million small businesses in this country, nearly half of employer firms are organized as S Corporations and 11%

partnerships. For those firms without employees, 86.4% are sole proprietorships. All of these pass-through companies pay the individual tax rate.

As with many small businesses in the United States, Neutral Posture is organized as S corporation. The S corporation was designed by Congress to encourage the formation and growth of family businesses, and it has been succeeding at that task for more than half a century. That said, under today's tax code, this classification can make the process of filing your taxes hopelessly complicated. I'm a perfect example. My most recent personal tax return was 79 pages long.

That complexity is coupled with higher tax rates. The 35 percent rate the U.S. imposes on corporations is one of the highest in the world. But S corporation like mine pay an even higher rate – 39.6 percent or more. According to the Tax Foundation, on the federal level, pass-through businesses are subject to a top marginal tax rate of 44.6 percent. This means that, in most U.S. states, pass-through businesses can face marginal tax rates that exceed 47 percent.

A recent report by American University's Kogod Tax Policy Center, which used a national survey of women business owners conducted by Women Impacting Public Policy highlighted the fact that women-owned businesses miss out on more than $255 billion in tax incentives because of the industries they are in and their form of organization.

Cutting the corporate rate is badly needed, but rates need to come down for all businesses, regardless of how they are organized. The goal should be to allow entrepreneurs to keep more of their earnings so they have the ability to reinvest their profits, increase output, and hire more workers.

We shouldn't stop there. In the furniture industry, we face heavy competition from foreign importers. Companies that sell cheaper, less-reliable products from countries like China import those products with a significant tax advantage.

The U.S. tax code has essentially created a foreign import subsidy at the expense of American-based businesses and workers, paid for by taxpayers. Eliminating the foreign-goods subsidy and allowing American producers to write-off capital investments more quickly would help companies like mine

Another challenge small businesses face is the estate tax. If someone happens to claim a significant share of a family-owned small business as an asset, the heirs to that asset can potentially be penalized to the point that the company no longer survives.

In our case, my mother owns 44 percent of our business. If she were to pass away, we would be unable to pay the ensuing tax burden. That's right: if you clear all the other hurdles and manage to create a successful business, the estate tax jeopardizes passing it onto future generations. The estate tax amounts to double jeopardy on income and assets that have already been taxed. It should be eliminated permanently.

In conclusion, I am recommending equal tax treatment for businesses, no matter how they are formed, elimination of the estate tax and simplification of the tax code for everyone and these changes need to permanent. Small businesses cannot plan for the future with a changing tax code. Mr. Chairman, thank you again for bringing this issue to light. We look forward to working with you. I would be happy to answer any questions.

Chairman Roskam. Thank you, Ms. Boenigk.

Ms. Huang.

STATEMENT OF CHYE-CHING HUANG, DEPUTY DIRECTOR-FEDERAL TAX POLICY, CENTER ON BUDGET AND POLICY PRIORITIES

Ms.Huang. Chairman Roskam, Ranking Member Doggett, and members of the subcommittee, thank you for the opportunity to testify here today. My name is Chye-Ching Huang, and I am the Deputy Director of the Center on Budget and Policy Priorities. And we absolutely agree that how tax reform affects small businesses and their employees is very important. I would like to offer 5 points on that issue.

First, is that a special rate for pass-through businesses would overwhelmingly benefit the wealthy and tax avoiders and not typical small businesses. Pass-through business income is claimed on individual tax returns and currently taxed at the same rate a salaries. The administration and Better Way tax plans both cut the top rates on pass-through income. They cut it from 39.6 percent to 15 percent and 25 percent respectively. And that is well below the plan's proposed top tax rate on salaries.

The benefits of cutting that rate would go overwhelmingly to the wealthy. The country's 400 highest income individuals would get average tax cuts of 9 million each, each year. And more than two-thirds of that tax cut would go to millionaires. And that is because pass-through income is highly concentrated among big businesses and high-income households: Hedge fund managers, consultants, investment bankers, lawyers, and the like. Plus, the tax cut would lose more than half a trillion dollars over the next 10 years purely due to tax avoidance.

High-earning executives and professionals would have a major incentive to reclassify their salaries as business income in order to get the lower rate. Meanwhile, cutting the top pass-through rates wouldn't help most small businesses which are, in fact, small.

So almost 70 percent of households with pass-through business income are already taxed at a lower statutory marginal rate of 15 percent or below. And, as we have heard, many farm businesses already face those lower rates.

Second, and similarly, repealing the estate tax would not be a boon to most small businesses, but to the heirs of the wealthiest estates in the country. Only about 50 small business estates face any tax each year, and those that do face an effective rate of 6 percent. And that is mostly because the first $11 million in assets, per couple, is entirely exempt from the tax. So repealing the tax would benefit the heirs of only the wealthiest two of every 1,000 estates.

Third, we can learn a lesson from the failed tax cut experiment in the State of Kansas. Kansas enacted large tax cuts highly skewed to the top including special treatment for pass-throughs. And since that took effect, Kansas lagged the Nation in small business job growth, overall employment growth, and economic growth.

Just to address the deficits fueled by those tax cuts, Kansas cut investments that helped communities and businesses thrive, including delaying road repairs and underfunding schools. And, last month, a bipartisan super majority of the Kansas legislature reversed most of those tax cuts.

My fourth point is that, like the Kansas plan, the administration and Better Way tax plans propose large deficit increasing tax cuts mostly for the wealthy and large businesses even beyond the pass-through and estate tax proposals. And paying for them either sooner or later could mean harm to education, infrastructure, and other Federal investments that are critical to the economy and to small businesses.

Fifth, I would like to note that the tax provisions in the House and Senate health bills would hurt small businesses. These are big tax plans, and they slash the tax credits that help people buy health insurance in the individual marketplace and cover their out-of-pocket costs. Small business owners and their employees disproportionately buy insurance in the marketplace. So they would be disproportionately hurt by increased premiums, losses of coverage, and increased out-of-pocket costs. The bills could also discourage people from starting a small business. Health reform allowed many Americans to buy affordable, quality coverage in the marketplace independent of an employer. And that makes it less costly and less risky for people, especially those with preexisting conditions, to change jobs and to start their own small business.

The House and Senate bills would reverse those gains, and they would do so, in large part, to pay for tax cuts that, again, go mostly to the wealthy, and to large drug companies, large insurance companies, and other corporations.

Thank you, again, for the opportunity to be here today, and I look forward to your questions.

Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

July 13, 2017

Tax Cuts for the Wealthy Would Do Little to Help Small Businesses and the Economy

Testimony of Chye-Ching Huang, Deputy Director, Federal Tax Policy, Center on Budget and Policy Priorities, Before the Committee on Ways and Means, Subcommittee on Tax Policy, U.S. House of Representatives

Chairman Roskam, Ranking Member Doggett, and other members of the Subcommittee, thank you for the opportunity to testify today on how tax reform could affect small businesses. I would like to offer five points:

1) **A special rate cut for "pass-through" businesses would overwhelmingly benefit the wealthy and tax avoiders, not small businesses.** This is a central element of both President Trump's tax plan and the "Better Way" tax plan. Some proponents say it would be a boon for small businesses. In reality, it would mostly help wealthy filers — such as hedge fund managers, investment bankers, and real estate investors — as well as high-earners who engage in tax avoidance by converting their salaries to pass-through income. Few typical Main Street small businesses would see a benefit. And domestic small businesses would not benefit President Trump's proposed "territorial" corporate tax system, and may be hurt by it.
2) **Eliminating the estate tax would be a boon to the heirs of the wealthiest estates in the country, not to small farms and small businesses.** Proponents of proposals to repeal or scale back the estate tax often assert that doing so would help small business owners and farms. But only about 50 small farms and businesses nationwide face *any* estate tax in a typical year, and those that do pay an effective rate of 6 percent. This is primarily because the estate tax exempts $11 million in assets per couple — the same reason why repealing it would be a windfall for the heirs of only the wealthiest 2 of every 1,000 estates in the country.
3) **Kansas' failed experiment of large, top-tilted income-tax cuts, including special treatment for pass-throughs, did not supercharge economic growth. Instead, it damaged services and investments that help businesses and communities thrive.** Since its big tax cuts took effect in January 2013, Kansas has lagged the nation in both private employment growth and economic growth. To address budget deficits fueled by the tax cuts, Kansas cut services and investments, including delaying infrastructure repairs and

underfunding education. In June, bipartisan supermajorities in the Kansas House and Senate overrode Governor Brownback's veto and reversed most of the tax cuts. The federal government does not have to balance its budget every year, but in the long run, large deficit-increasing tax cuts will create pressure to cut services and investments that support a strong economy.

4) **Paying for the tax cuts for the affluent and large corporations in the Trump and "Better Way" tax plans could result in harm to education, infrastructure, and other federal investments critical to the economy and small businesses**. These tax plans propose large, costly tax cuts that overwhelmingly flow to the wealthy and large profitable corporations, but the plans don't propose credible ways to fully offset the cost by scaling back tax breaks or through other sources of revenue. Instead, President Trump's budget, and the emerging House Budget Committee plan, apparently would pair tax cuts with cuts to domestic investments that could weaken the economy and harm small businesses over time. For example, the Trump budget proposes substantial cuts in areas including job training, education, and infrastructure.

5) **Tax provisions in the House and Senate health bills would hurt small businesses.** These bills would cut the tax credits that help people purchase premiums in the marketplace and afford out-of-pocket costs, and undo other reforms that help people who buy coverage in the individual market. Small business owners and their employees would be disproportionately affected, as they disproportionately rely on the marketplace to buy health insurance. Not only would small businesses and workers face coverage losses or increased premiums and deductibles, but the bills could also make people more reliant on employer insurance and create a barrier to starting a business. In addition, the bills would use these cuts to coverage and care to help pay for tax cuts, which would mostly go to high-income households and large drug and insurance companies and other corporations.

I'll now cover each of these five points in more detail.

(1) "Pass-through" tax break would benefit the wealthy and do little for typical small businesses

A centerpiece of President Trump's tax plan and the "Better Way" tax plan is a special, much lower top rate for "pass-through" business income — income from businesses such as partnerships, S corporations, and sole proprietorships that is claimed on individual tax returns and currently taxed at the same rates as wages and salaries. Both the Administration and "Better Way" plans would sharply cut the top rate on this income, from 39.6 percent to 15 and 25 percent, respectively — well below the plans' proposed top individual income tax rates of 35 and 33 percent. Far from benefiting the typical "Mom and Pop" small business owner, these proposals would overwhelmingly benefit high-wealth households and tax avoiders.

Tax cut would flow overwhelmingly to large businesses, the very wealthy, and tax avoiders

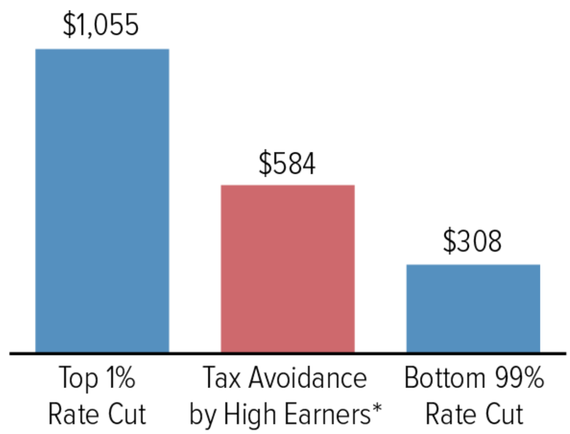
The biggest beneficiaries of a special pass-through tax rate would be wealthy households and very large, profitable businesses, since they receive most pass-through income and would receive the biggest rate cuts. They include (the list below contains overlapping categories):

- Households with incomes above $1 million, who would receive more than two-thirds of the $1.4 trillion cost of cutting the top tax rate on existing pass-through income to 15 percent, the Tax Policy Center (TPC) estimates.[1] Millionaires would receive tax cuts averaging $114,000 apiece in 2018, a more than 5 percent boost in their after-tax incomes.
- Hedge fund managers, lawyers, consultants, and investment managers, who make up a significant share of pass-through business owners in the top tax bracket.[2]
- The 0.4 percent of S corporations that have receipts exceeding $50 million annually and make 40 percent of all S corporation income, and the 0.3 percent of partnerships that have receipts exceeding $50 million and make 70 percent of partnership income.[3]
- The country's 400 highest-income households, whose average annual incomes exceed $300 million apiece and who receive an average of one-fifth of their income from pass-throughs.[4] Estimated conservatively, President Trump's pass-through rate cut would give these households a tax cut averaging about $9 million each compared to current income tax rates, and about $7.5 million each compared to the 35 percent top rate on "ordinary" income under the Trump tax plan.
- Business owners like President Trump, who reportedly holds about 500 pass-through businesses.[5]

FIGURE 1

Trump-Like Pass-Through Tax Cut Delivers More to Top 1 Percent and Tax Avoiders Than Everyone Else Combined

Revenue loss in billions of dollars, 2018-2027



Note: President Trump has proposed to let owners of such businesses as partnerships, S corporations, and sole proprietorships pay only a 15 percent tax on their earnings, known as "pass-through income" income. The figures in this chart reflect a Tax Policy Center analysis of a very similar proposal but with a 33 percent top individual income tax rate (versus 35 in Trump's plan). Estimates do not include impact of cutting the top individual income tax rate to 33 percent.

*High earners reclassifying their salary income as pass-through income in order to pay a lower tax rate.

Source: Tax Policy Center Tables T17-0162 and T17-0164.

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[1] Jeffrey Rohaly, Joseph Rosenberg, and Eric Toder, "Options to Reduce the Taxation of Pass-Through Income," TPC, May 16, 2017, http://tpc.io/2qoxsmJ. Also see Chuck Marr, Chye-Ching Huang, Brandon DeBot, and Guillermo Herrera, "Trump Tax Plan's Pass-Through Tax Break Would Provide Massive Windfall to the Wealthy," CBPP, May 22, 2017, http://bit.ly/2v7SoQ0 for description of TPC estimates.

[2] Frank Sammartino, "Taxation of Pass-Through Businesses," TPC, January 30, 2017, http://tpc.io/2t9hyfN.

[3] Joint Committee on Taxation tabulations using IRS Statistics of Income data. See Tables 4 and 5 in Joint Committee on Taxation, "Background on Business Tax Reform," April 22, 2016, http://bit.ly/2uMaA25.

[4] Marr, Huang, DeBot, and Herrera.

[5] Sheri A. Dillon and William F. Nelson, "Re: Status of U.S. federal income tax returns," Morgan, Lewis & Bockius LLP, March 7, 2016, http://bit.ly/2sZZoBU.

A special lower tax rate for pass-through income would also spur large-scale tax avoidance by high earners, who would have a major incentive to reclassify their salaries as "business income" to get the lower pass-through rate. For example, a lawyer who reclassified her $1 million salary as business income from the law firm would save $200,000 in taxes under the Trump provision.

Indeed, TPC estimates that about 30 percent of the $1.9 trillion cost of cutting the top tax rate on pass-through income to 15 percent would come purely from such tax avoidance. That is, the proposal would lose $584 billion to tax avoidance by high earners alone. That substantially exceeds the total tax cut the proposal would provide for the bottom 99 percent of the population. (See Figure 1.)

It would be hard to prevent such gaming. Congress and the IRS already struggle to design and enforce rules to stop high earners from reclassifying their salaries as business income to avoid payroll taxes. This tax break would greatly increase the incentive to use these types of schemes, and tax experts from across the political spectrum are rightly skeptical that it would be possible to design and enforce effective anti-avoidance rules.[6] This is especially so given that the IRS budget has been cut substantially in recent years, leading to weaker enforcement activities including fewer audits of high-income taxpayers and businesses.[7] The Administration and the House Financial Services and General Government Appropriations subcommittee have proposed new cuts in the IRS budget on top of that.

Tax cut wouldn't help most small businesses

Most small businesses are in fact small, and most small business owners' incomes are already taxed at lower rates than the top rate in the Trump and "Better Way" proposals, so they would not benefit from cutting tax rates that high-income filers face.

Almost 70 percent of filers with pass-through income are currently taxed at a statutory marginal income tax rate of 0, 10, or 15 percent.[8] More than 97 percent of filers with pass-through income face statutory marginal income tax rates below 33 percent. TPC analysis finds that only about 2 percent of households with incomes below $100,000 would get *any* tax cut from the provision. (See Figure 2).

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[6] See Box 2 in Marr, Huang, DeBot, and Herrera, and Joseph Henchman, "Kansas May Drop Pass-Through Exclusion After Revenue Projections Miss Mark Again," Tax Foundation, April 30, 2015, http://bit.ly/2u96p2L.

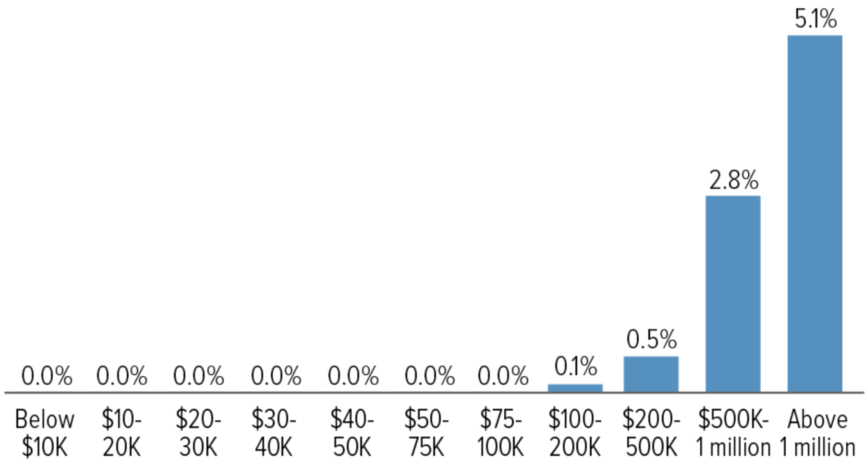
[7] Brandon DeBot, Emily Horton, and Chuck Marr, "Trump Budget Continues Multi-Year Assault on IRS Funding Despite Mnuchin's Call for More Resources," CBPP, March 16, 2017, http://bit.ly/2npTvYb.

[8] Similarly, a Treasury analysis of small business owners — more narrowly defined — in 2010 shows 67 percent already face rates of 15 percent or lower. These estimates define a small business owner as someone deriving at least 25 percent of his or her adjusted gross income from a small business. They define a small business as one with at least $5,000 in deductions for activities considered "businesslike" (such as expenses related to employees, inventories, office supplies, and rent) and income and deductions of less than $10 million. Matthew Knittel *et al.,* "Methodology to Identify Small Businesses and Their Owners," Office of Tax Analysis Department of the Treasury, Technical Paper 4, August 2011, Table 17, http://bit.ly/2v7G7Ly.

FIGURE 2

Trump-Like Pass-Through Rate Cut Would Not Benefit Low- and Middle-Income Americans

Percent change in after-tax income by income group, 2018



Note: Trump proposal would let owners of such businesses as partnerships, S corporations, and sole proprietorships pay only 15 percent tax on their earnings, known as "pass-through" income. Figures here reflect Tax Policy Center analysis of very similar proposal but with 33 percent top individual income tax rate (versus 35 percent in Trump plan). Estimates do not include impact of cutting top rate to 33 percent or tax avoidance by high earners to take advantage of pass-through rate.

Source: Tax Policy Center Table T17-0163

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Proponents argue that a lower pass-through rate is necessary to establish "parity" between taxes paid by pass-throughs and C corporations, which pay the corporate income tax. But pass-throughs pay only the individual tax, while C corporation profits may face the corporate income tax and, when distributed to shareholders, the tax on dividends. Setting the top rate on pass-through income equal to the top corporate tax rate therefore means that pass-through income will, on average, be taxed at *lower* rates than C corporation income.[9] Indeed, many businesses already choose to be taxed as pass-through entities instead of as corporations because it *lowers* their total taxes.

[9] For new investments, pass-through businesses would face marginal effective tax rates of 2.6 and 2.5 percent under the Trump campaign tax plan and House GOP proposal, respectively, according to TPC. In comparison, C corporations would face marginal effective tax rates of 9.5 and 8.8 percent under these plans, respectively. See James R. Nunns, Leonard E. Burman, Jeffrey Rohaly, and Joseph Rosenberg, "An Analysis of Donald Trump's Revised Tax Plan," TPC, October 18, 2016, http://tpc.io/2f5xYjZ ; and James R. Nunns, Leonard E. Burman, Jeffrey Rohaly, Joseph Rosenberg, and Benjamin R. Page, "Dynamic Analysis of the House GOP Tax Plan: An Update," TPC, June 30, 2017, http://tpc.io/2uKUhlt.

The Trump plan would pair a pass-through proposal that does little for small businesses with a "territorial" tax system that gives a zero tax rate to large multinationals' foreign profits

President Trump has proposed a territorial tax system: U.S.-based multinational corporations wouldn't pay U.S. corporate taxes on their foreign profits, while domestic businesses would face a 15 percent rate. This could make U.S. domestic and small businesses less competitive relative to large U.S. multinationals.

Large U.S. multinationals can pay tax lawyers millions of dollars in fees to find ways to report U.S. profits as being earned offshore in order to get the zero tax rate on "foreign" profits under a territorial system. That would give them a huge tax advantage over U.S. businesses — including small businesses — that don't have foreign operations and can't orchestrate complex tax avoidance maneuvers. The tax avoidance savings that corporations would reap would favor profitable U.S. multinationals, especially those in industries that can easily move profits overseas, such as pharmaceuticals and software.[10]

(2) Few small business and small farm estates would benefit from estate tax repeal

The estate tax affects very few small farms and businesses and is not a heavy burden for those that do face the tax. Only 50 small farm or business estates nationwide will face the tax in 2017 (see Figure 3), TPC estimates, and these few estates will owe less than 6 percent of their value in tax, on average.[11] This is primarily because the first $5.49 million of assets per person ($10.98 million per couple) are exempt from the estate tax.

The *New York Times* reported in 2001, when the estate tax applied to far more estates than it does today: "Even one of the leading advocates for repeal of estate taxes, the American Farm Bureau Federation, said it could not cite a single example of a farm lost because of estate taxes."[12] Moreover, most farmers and business owners with estates large enough to owe any tax have sufficient liquid assets (such as bank accounts, stocks, and bonds) to pay the tax without having to touch other assets or liquidate their farm and business, a 2005 Congressional Budget Office (CBO) study found.[13] Today's estate tax rules are much more generous than those in 2001, and more generous than CBO assumed in its analysis.

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[10] CBPP, ""Territorial Tax" Is a Zero Rate on U.S. Multinationals' Foreign Profits, Threatens U.S. Revenues and Wages," May 16, 2017, http://bit.ly/2uNwJx6.

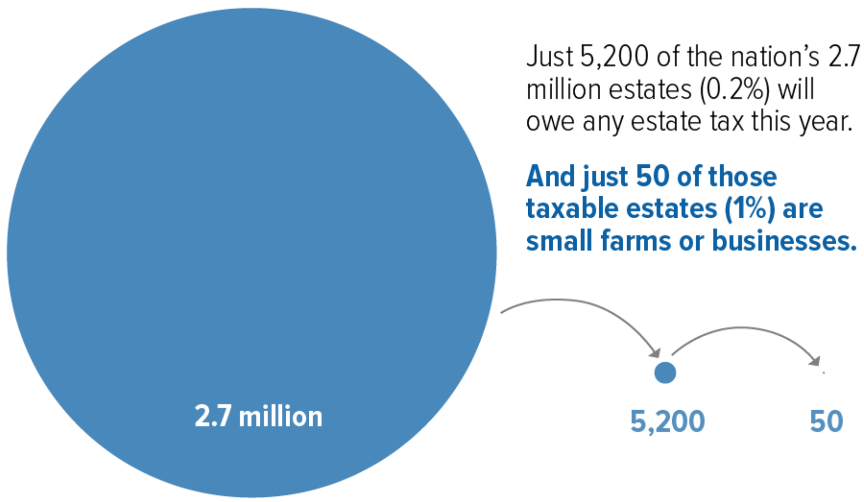
[11] TPC table T16-0277, http://tpc.io/2t9BwHd. TPC defines a small business or small farm estate as one for which farm and business assets are at least half of gross estate and these assets total no more than $5 million. Similarly, the Department of Agriculture (USDA) finds that only about 0.4 percent of *all* farm estates face the tax. This figure includes estates that may not have accumulated the bulk of their assets or income from farming activity. For more details, see USDA, Economic Research Service, "Federal Estate Taxes," updated March 15, 2017, http://bit.ly/2tE9mHN.

[12] David Cay Johnston, "Talk of Lost Farms Reflects Muddle of Estate Tax Debate," *New York Times*, April 8, 2001, http://nyti.ms/1Of3vvD.

[13] Congressional Budget Office (CBO), "Effects of the Federal Estate Tax on Farms and Small Businesses," July 2005, https://www.cbo.gov/publication/16897.

FIGURE 3

Only 50 Small Farms or Businesses Face Estate Tax



Note: The area of each pie is scaled to the number of estates. Small farms or businesses are estates whose farm and business assets total no more than $5 million and represent at least half of their gross value.

Source: Tax Policy Center

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Further, farm and business estates that are large enough to owe estate tax can benefit from a variety of other rules that lessen the impact of the tax. For example, farm and business estates are generally eligible to defer payment of estate tax (paying only interest) for five years and then to pay the tax in up to ten annual installments. This enables farm and business owners with large estates but few liquid assets to pay the estate tax without selling the farm or business.[14]

While doing very little for small farms and small businesses, repeal would provide a windfall to the wealthiest 0.2 percent of estates — the only ones large enough to pay the tax. The repeal proposal introduced in the House and Senate this year would provide the 0.2 percent of wealthiest estates with an average tax cut of more than $3 million in 2017, the Joint Committee on Taxation (JCT) estimates. Roughly 330 estates worth more than $50 million would get more than $20 million apiece in tax cuts, JCT estimates. Repeal would cost $269 billion over ten years.[15]

[14] Other provisions that further reduce estate tax requirements on the very few farms and small businesses that are large enough to face it include the ability to value farmland for the purposes of calculating the estate tax based on its value as a farm (rather than at the land's fair market value, which may be higher because the land could be more valuable if used for something other than farming), minority and marketability discounts, and easement donation rules. See Gillian Brunet and Chye-Ching Huang, "Unlimited Estate Tax Exemption for Farm Estates Is Unnecessary and Likely Harmful," CBPP, June 29, 2010, http://bit.ly/2sLgVcX.

[15] JCT analyses of H.R. 1105, the "Death Tax Repeal Act of 2015," at http://bit.ly/2u91aQu and http://bit.ly/1HeVtzH. The bill was reintroduced in 2017 as H.R. 631 and S. 205, both titled the "Death Tax Repeal Act of 2017."

(3) The failed Kansas tax cut experiment of large, top-tilted income tax cuts, including special treatment for pass-throughs, did not supercharge economic growth. Instead, it damaged services and investments that help businesses and communities thrive.

Kansas is a clear case of how costly top-tilted tax cuts — including a special rate for pass-throughs — do not supercharge economic growth but instead dig a revenue hole leading to damaging cuts to services and investments. As part of an aggressive set of tax cuts championed by Governor Sam Brownback, in 2012 Kansas cut income tax rates steeply and exempted pass-through income from all state income taxes.

The promised immediate economic boom failed to occur. Since the tax cuts took effect in January 2013, Kansas has lagged the nation in both private employment growth and economic growth. Meanwhile, the tax cuts wreaked havoc on the state's budget, with the pass-through exemption alone costing hundreds of millions a year. To balance its budget, the state employed gimmicks and one-time revenues, delayed road projects, cut services, and nearly drained funds it had set aside to prepare for the next recession. Earlier this year, the Kansas Supreme Court ruled that state funding for K-12 education was now inadequate. In addition, two bond rating agencies downgraded the state due to its budget problems. A recent study of the pass-through exemption did not find any measurable boost in real economic activity because of it; instead, the results suggested that "the primary effect of the policy was to induce taxpayers to re-characterize income as pass-through business income."[16]

A bipartisan two-thirds majority of the Kansas legislature overrode Gov. Brownback's veto in June and reversed most of the tax cuts — including repealing the pass-through exemption. The Republican Majority Leader of the Kansas House of Representatives Don Hineman wrote:[17]

> … As predicted by those of us who opposed [Gov. Brownback's tax cut measure], Kansas faced massive budget deficits. And when they came, the governor urged the Legislature to increase the sales tax, issue billions in new debt, sweep from the highway fund and use one-time sources of funding just to pay the bills. Finally, the Legislature said "enough is enough" and rejected the governor's short-term fixes as being neither responsible nor conservative.
>
> The fiscal strain created by the 2012 tax cuts caused public schools to suffer, increasing class sizes and reducing program offerings. Medicaid reimbursements were reduced, straining rural hospital budgets heavily reliant on those payments. Highway funds for preservation and maintenance were cut to unsustainably low levels. And despite the assurances of adviser Art Laffer that economic nirvana was just around the corner, Kansans continued to move out of state. Brownback and his allies insisted that his tax plan was working, offering as evidence cherry-picked data such as unemployment rate and new business starts. Those are not reliable indicators of economic growth, however, and plenty of other data shows a Kansas economy which continues to lag its neighbors and the nation. . . . It took years to get us into such a dire situation, and it will take years for us to recover.

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[16] Jason DeBacker, Bradley T. Heim, Shanthi P. Ramnath, and Justin M. Ross, "The Impact of State Taxes on Pass-Through Businesses: Evidence from the 2012 Kansas Income Tax Reform," July 2016, http://bit.ly/2tDUfOG.

[17] Don Hineman, "Rep. Don Hineman: Why tax reform was necessary," *Topeka Capital-Journal*, updated July 5, 2017, http://bit.ly/2udIJLv.

The federal government does not have to balance its budget in every year like Kansas, but it cannot allow debt to grow ever larger as a share of the economy in the long run, and both the Trump Administration and the House GOP leadership have adopted budget frameworks and policy proposals that would pair their tax cuts with large cuts to domestic investments. As Duane Goosen, a former Kansas budget director, said of the Kansas experiment: [18] "This is a major lesson certainly for other states but also for Congress because what Trump has proposed is kind of the Brownback tax plan on steroids … and we're going to get the same result out of that. Congress, the rest of the United States ought to look carefully at what happened to us."

(4) Paying for tax cuts for the wealthy and large corporations could harm education, infrastructure, and other federal investments important to the economy and small businesses

The Administration and "Better Way" tax plans would enlarge budget deficits and thus make it more likely that various investments that support a strong economy would be underfunded or cut in the future. The Administration's budget — and, reportedly, the forthcoming plan from the House Budget Committee chair, as well — call for cuts in areas vital to the economy and businesses.

The Administration and "Better Way" plans both propose costly tax cuts that overwhelmingly would go to the wealthy and to large, profitable corporations, but give no credible way to fully offset the cost. The "Better Way" plan would reduce revenues by $3.1 trillion from 2016 through 2026, even counting its revenue-raising provisions, TPC estimates. Millionaires would receive tax cuts averaging $302,000 in 2025, an 11 percent increase in their after-tax incomes. Indeed, millionaires would reap 96 percent of the Better Way plan's total tax cuts in 2025, and roughly $2.6 trillion in tax cuts over the first decade (see Figure 4).[19] Moreover, using mainstream economic models and assumptions, TPC estimates that because of the adverse effect of increased deficits on growth over time, by the end of the decade the "Better Way" plan would *reduce* economic growth.[20]

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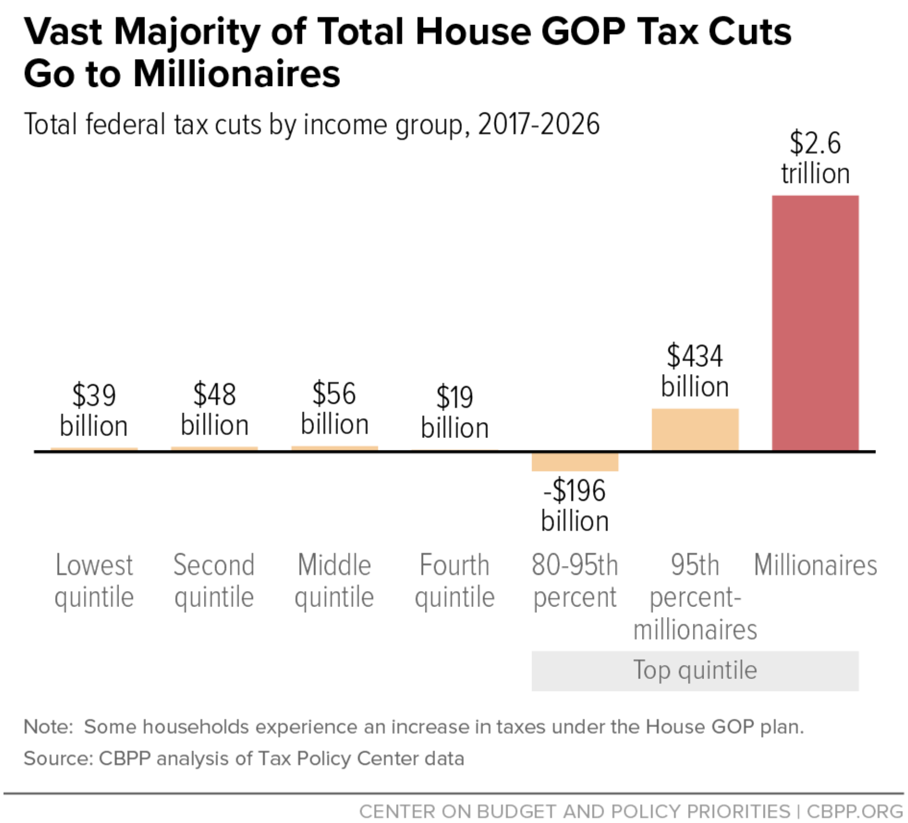
[18] Brian Lowry and Scott Canon, "Kansas tax 'experiment' offers lessons to the nation, analysts say," *Kansas City Star*, June 7, 2017, http://bit.ly/2t09Sg9 .

[19] CBPP analysis based on Page, "Dynamic Analysis of the House GOP Tax Plan: An Update." See Isaac Shapiro, Chye-Ching Huang, and Richard Kogan, "House GOP Framework Would Give Millionaires $2.6 Trillion in Tax Cuts, While Cutting Programs for Low- and Moderate-Income People by $3.7 Trillion," CBPP, September 29, 2016, http://bit.ly/2deCtbe.

[20] *Ibid.* TPC has not done a macroeconomic analysis of the Trump Administration tax plan, but found that the Trump campaign tax plan would reduce growth by the end of the decade: see James R. Nunns *et al.*, "An Analysis of Donald Trump's Revised Tax Plan," TPC, October 18, 2016, http://tpc.io/2f5xYjZ.

FIGURE 4



The Administration's tax plan would cost more than $5 trillion over ten years and would also be skewed to the top, delivering net tax cuts of more than $250,000 a year to the top 1 percent.[21]

To reduce projected long-run deficits and debt, and to meet the fiscal demands of an aging population, federal tax reform should aim to increase revenues. Otherwise, the entire burden of reducing the deficit to prevent unsustainable debt levels will fall on federal programs, likely ultimately including Social Security and Medicare. This is why, at an absolute minimum, tax reform should certainly not lose revenues. The Administration and "Better Way" tax plans, however, lose trillions in revenue, increasing the pressure for damaging cuts to federal investments and services to pay for them and making it harder to make new investments in infrastructure, education, and other areas critical to U.S. businesses and workers.[22]

Further, even while the Administration's budget shows no cost for its tax plan, it— and the emerging House budget plan – include calls for cuts to domestic investments that could damage small businesses and the economy. For example:

[21] CBPP, "Trump Budget's Radical, Harmful Priorities," May 26, 2017, http://bit.ly/2s45IDr.

[22] CBPP, "Tax Reform Should Raise Revenues — And Certainly Not Lose Them," April 26, 2017, http://bit.ly/2oSQfoB.

- The Administration's budget — and reportedly House Budget Committee Chair Diane Black's emerging budget plan — would **cut non-defense discretionary (NDD) programs** below the already inadequate sequestration levels. NDD funds key investments including education, job training, scientific and medical research, infrastructure, and other programs that promote economic growth and support domestic businesses, as well as an array of vital public services.[23]
- The Administration's budget specifically proposes **cuts in job training and education** and hence would make it more challenging to develop the skilled workforce that small businesses need. It would in 2018: slash Workforce Innovation and Opportunity Act job training grants to the states for adults, dislocated workers, and youth by 40 percent; cut student aid and end a provision adjusting Pell Grants for inflation, making college less affordable for many low-income students; and cut the Education Department's elementary and secondary programs by $4 billion.[24]
- The President's budget would ***weaken* federal support for infrastructure in the long run** by reducing Highway Trust Fund spending, cutting discretionary infrastructure investments, and shifting costs to states and localities. The Trump budget proposes limiting Highway Trust Fund spending to the dedicated revenues it receives, starting in 2021. That means significant cuts in Highway Trust Fund spending that would grow over time, reaching $20 billion a year by the end of ten years and extending indefinitely.[25]

So far, neither the Administration nor House leaders have proposed any credible ways to fully offset the cost of their tax plans by scaling back tax breaks or through other sources of revenue. As a result, either immediately or eventually, small businesses and their employees would bear some of the burden of spending cuts to pay for these large tax cuts overwhelmingly tilted to those at the top of the income scale and profitable corporations — spending cuts that would come on top of those already proposed by the Administration and likely the House GOP.

(5) Tax and other provisions in the House and Senate GOP *health* bills would hurt small businesses

The House-passed American Health Care Act (AHCA) and the Senate's Better Care Reconciliation Act (BCRA) include major tax changes and other provisions that would disproportionately hurt small businesses and their workers and could discourage entrepreneurship.

Small business owners and their employees would be disproportionately impacted by the large reductions the AHCA and BCRA would make to tax credits that help people buy health insurance in the marketplace and pay for out-of-pocket costs. The House and Senate bills would cut the tax credits that now help people with incomes below 400 percent of the poverty line — about $48,000 for a single person — purchase coverage in the marketplace (and would eliminate the subsidies that help people below 2½ times the poverty line afford out-of-pocket costs). Small business owners

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[23] See CBPP, "Trump Budget's Radical, Harmful Priorities," and also Joel Friedman, "Black's Lopsided Budget Is a Dead End for Appropriations," CBPP, June 26, 2017, http://bit.ly/2u9qKVr .

[24] Sharon Parrott, "Contrary to Rhetoric, Trump Budget Would Make It Harder for Many to Climb Economic Ladder," CBPP, May 31, 2017, http://bit.ly/2sLDbmU.

[25] Jacob Leibenluft, "Trump's Bait and Switch on Infrastructure," CBPP, June 7, 2017, http://bit.ly/2tJs5QM.

disproportionately depend on the marketplace for health insurance: small business owners and self-employed workers are more than three times more likely than other workers to buy insurance through the marketplace, and accounted for 1 in 5 marketplace consumers in 2014.[26] Likewise, people who work for small businesses have seen even larger gains in coverage under the ACA than other workers, reflecting the fact that they are less likely to have coverage through their employers and thus benefit disproportionately from the ACA's subsidies and other reforms for people buying coverage in the individual market.[27] Small businesses and their employees would therefore disproportionately face the effects of the BCRA and AHCA's changes to marketplace assistance: losses in coverage or large increases in net premiums and/or deductibles.[28]

The AHCA and BCRA could also discourage entrepreneurship. Health reform enabled millions of Americans to obtain affordable, quality health coverage in the marketplace, independent of an employer, making it less costly and risky for people to change jobs or start their own business. The Affordable Care Act's marketplace reforms mean that 1.5 million more people are self-employed than would otherwise have been, Urban Institute and Georgetown University health researchers estimate.[29]

By making marketplace coverage less affordable, including through cuts to tax credits, the BCRA and AHCA could resurrect a barrier to starting a business. Further, staying with an employer to maintain insurance was a particular issue for many people with pre-existing conditions before health reform and would be again under the AHCA and BCRA, which would (at state option) let plans go back to excluding key benefits that people with pre-existing conditions need.[30] As Senator Collins notes, "There is no denying that the Affordable Care Act has made insurance available to millions of Americans and allowed people to leave corporate jobs and start businesses."[31] Cutting subsidies and reversing the ACA's reforms would reverse those gains.

The ACHA and BCRA's cuts to tax credits and other coverage provisions that help small businesses, their workers, and millions of other Americans would, in part, go to fund hundreds of billions of dollars in tax cuts overwhelmingly for high-income households and large drug companies, insurers, and other corporations.[32]

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26 Adam Looney and Kathryn Martin, "One in Five 2014 Marketplace Consumers was a Small Business Owner or Self-Employed," U.S. Department of Treasury, January 12, 2017, http://bit.ly/2lFdQa7.

27 Figure 1 in Richard Frank, testimony to U.S. Senate Committee on Small Business and Entrepreneurship, "Impact of the ACA on Small Business," May 18, 2016, http://bit.ly/2u4h7b8.

28 Aviva Aron-Dine and Tara Straw, "Senate Bill Still Cuts Tax Credits, Increases Premiums and Deductibles for Marketplace Consumers," CBPP, updated June 25, 2017, http://bit.ly/2sBCkaO.

29 Linda Blumberg, Sabrina Corlette, and Kevin Lucia, "The Affordable Care Act: Improving Incentives for Entrepreneurship and Self-Employment," Urban Institute, May 2013, http://urbn.is/2sOhjrV.

30 Sarah Lueck, "If Senate Republican Health Bill Weakens Essential Health Benefits Standards, It Would Harm People with Pre-Existing Conditions," CBPP, June 12, 2017, http://bit.ly/2tJi45W.

31 Jennifer Steinhauer, "From Maine, a Call for a More Measured Take on Health Care," *New York Times*, June 4, 2017, http://nyti.ms/2rCpUNP.

32 The bills also repeal the tax credit that helps businesses with fewer than 25 employees afford premiums for their employees. For more on the tax cuts for drug and insurance companies and high-income individuals, see Chye-Ching Huang and Brandon DeBot, "House Health Bill: Tax Cuts for Wealthy, Insurers, and Drug Companies Paid for by Low-and Middle-Income Families," CBPP, updated May 22, 2017, http://bit.ly/2qSmqZe.

Chairman Roskam. Thank you all very much. We really appreciate your testimony. Now we will invite the members to inquire, and I will yield to Mr. Reichert from Washington.

Mr. Reichert. Thank you, Mr. Chairman. Thanks to all the witnesses for being here today and sharing your testimony.

I want to direct my questions toward Ms. Meares. As we talked before the hearing, I can really relate to your testimony. You and I have taken what we have learned in our years in law enforcement to serve our communities in a new way. And there are a couple of things that I have learned in my law enforcement career, and here in Congress, is that perseverance is one of those attributes that helps me be successful here, and also a very keen attention to facts.

And I know that you have those same two qualities. And they are needed desperately for you, I know, to be successful in the operation of your small business. So I have admired how you have used your skills from your 20 years of law enforcement. So thank you for your service to your community in that regard.

So just a couple of questions. First, could you describe the biggest challenges you faced when setting up your business?

Ms. Meares. The biggest challenge that I faced -- I am sorry. Finish the last part. I didn't hear.

Mr. Reichert. When you set up the business. When you started.

Ms. Meares. So the biggest challenge that I faced was two part. And that was adding employees, for me, also meant adding equipment. So if I add a sewing machine, or embroidery machine, or I added an outside sales person and I had to purchase samples in order for the person to go visit customers, it is two-fold. I am buying items for my company, and I am also hiring an employee to go with those items, and vice versa.

If I find myself growing at a fast rate, which is something that I faced both times, I have to build that infrastructure before I get to the point where the revenue supports it. And I probably don't fall in that risk-adverse category, obviously. So I have to make those expenses prior to having the revenue to support it.

So the biggest challenge that I have is being able to fund the employees that I have to hire to support the growth and infrastructure that I have, and then also get the equipment to go with it. Because they need a computer, and a desk, and a chair, and, you know, other products to support the job.

Mr. Reichert. And is there anything that you could identify today, as an update in the Tax Code, that could have helped you in that transition in acquiring property and hiring employees?

Ms. Meares. Yeah. As I referenced, I think the ability to write off more or write off the full expense of the items that we are buying and paying cash for in that year would definitely help me reinvest. In fact, if I am able to write off some of the larger machines that I purchase, that can actually support a part-time person to run the machine at the same time.

Mr. Reichert. Okay. And then the last question I want to have you focus on is now that you are starting your second business, or you are in the middle of your second business, and you have mentioned some things already as far as what can best help you now grow, continue to grow, your business, a simplified Tax Code, a lower tax rate. I want to give you a couple minutes to expand on those ideas, and if there is any other thoughts that you might be able to provide, and how we might better able assist you in the Tax Code and growing your business.

Ms. Meares. Obviously, you know, cash is king. And when you are growing a business, you don't have it. You know, it is just not there.

Mr. Reichert. Yeah.

Ms. Meares. And so you have to be very creative. You have to have that perseverance, and you have to have the attention to detail. And one little slip -- as Rebecca had mentioned, one little slip and a lot of businesses may not survive. That $86,000 tax bill that she had, there is a lot of businesses that wouldn't survive that. I actually had that happen to me, and I wasn't sure I was going to survive it.

So having to make payments and our pay taxes on the revenue that we are earning, while we are trying to grow our business within the same year, having to make those tax payments on any revenue or profit that we make is what is scaring me as I grow my business. Because, right now, I am not as challenged. But I know from my previous venture that as I grow into the more multiple millions of dollars, and I continue to earn the revenue, having to pay that tax upfront, on top of hiring a new person, bringing in the equipment, any marketing, any funds that I need to support that, at the end of the day, there is just nothing left for me and my family.

Mr. Reichert. So, very quickly, Mr. Chairman, you know, this committee is focused on trying to create an opportunity for businesses to grow. And I think you will find that as a bipartisan effort. Mr. Kind and I are working on two bills that, hopefully, will help. And Mr. Kind and I have also introduced legislation to promote employee ownership and provide greater retirement security through legislation that encourages the creation of more S corporation ESOPs. And I don't time to go into the second bill.

But I yield back. Thank you. Thank you for your testimony.

Chairman Roskam. Mr. Doggett.

Mr. Doggett. Thank you, so much, Mr. Chairman. I believe that each of our witnesses has offered valuable insights. The fact that we have differing opinions on these issues and we can have them discussed here is how we eventually perfect where we need to be.

I am disappointed that John Arensmeyer, representing the Small Business Majority, was denied an opportunity to testify today. I believe that it is important to continue, particularly given the lateness of our endeavors here, to have the most diverse points of view reflected here as we consider this. And I will continue respectfully urging that as we have other hearings.

Ms. Meares, I agree with you that depreciation schedules can be confusing and that it is helpful to small business to be able to expense capital investments. As you, I am no doubt aware, under Section 179, small businesses can already expense a half a million dollars every year, which is a lot of sewing machines, even though I am sure yours is not the kind that my wife has. I think that being able to expense every year $500,000 is a good step forward.

Our depreciation schedules may need to be reviewed. But the idea that every manufacturer in the country can expense every dollar of capital investment is a rather radical change in our Tax Code, and one that I have some concern about. I don't think that it would benefit small business in any way because the small businesses can already automatically expense.

Mr. VanderWal, I particularly agree with the concerns that you expressed that the tradeoff for automatic expensing for the very largest companies in the country would be to deny interest expense on debt for farmers, and ranchers, and many of the small businesses that I represent.

You know, when I go out and meet with the Southside Chamber of Commerce in San Antonio, or the Hispanic chamber in Austin, what I am hearing from these small businesses is one of the major obstacles they face to growth is access to capital. They work with the SBA, or they work with an independent bank, or with groups that we have there like People Fund and LiftFund, to try to get access to capital. And the notion that having gotten access to capital for these small businesses, that they won't be able to deduct the interest on their loans, I think will have big impact.

I believe that there is a debt bias in our Tax Code. But to go, again, to a radical step of saying we are not going to permit these interest deductions because we will have automatic expensing, I find to be very problematic.

And, Ms. Boenigk, I appreciate your reference to the Tax Foundation. This is a group that is viewed here, I think, as being a Republican-leaning group. But I think that it offers a lot of wisdom about the pass-through. I believe and share your view that we need equal tax treatment for all companies.

But it is the tax foundation itself, the source that you mentioned, that has said, quote: The pass-through carve out primarily incentivizes tax avoidance, not job creation. In fact, nearly a third of the estimated cost of this tax break would come from the tax dodging bonanza that would follow it.

And just to give you an example, while you are here as small businesses, one of the companies that is entitled to a pass-through is somebody that I respect very much, and that is Michael Bloomberg. He was interviewed recently on 60 Minutes. He apparently has been so successful he is the eighth richest man in the world. But he doesn't have a corporation. He has a partnership that passes through his income. I think he is now worth $47 billion.

And so when we make decisions about pass-throughs we are not just talking about mom and pop enterprises. We are talking about very wealthy individuals. And if there aren't safeguards in there, this will just become the latest way that some people avoid paying the fair share of taxes that they are entitled -- that they should be doing to finance our national security.

Ms. Huang, I would just ask you if having additional tax breaks, a territorial system, for example, will be of any benefit to small businesses?

Ms. Huang. So a territorial tax system, simply put, means a rate of zero on multi-nationals' foreign profits, and that would be of no benefit whatsoever to domestic or small businesses and could, in fact, hurt them. And this is a key proposal that is in President Trump's current tax plan.

The problem is that it would give those multi-nationals a big incentive to artificially shift their profits offshore in order to get that zero tax rate. That puts them at a competitive advantage to domestic and small businesses who don't have access to high-priced lawyers, who don't have foreign subsidiaries, and who don't want to engage in tax avoidance as a business strategy.

Mr. Doggett. Thank you, Ms. Huang.

Chairman Roskam. Mr. Tiberi.

Mr. Tiberi. Thank you, Mr. Chairman. Congratulations on putting a great panel together of four really good folks. I really appreciate all your testimony.

Ms. Huang, love your accent, testimony not so much. It reminded me of a conversation I had recently with a constituent of mine who came to America with his parents -- born overseas -- came to America with his parents when he was six years old. First in his family to go to college, started a small business in his late twenties. And he said to me recently -- he said to me: I cannot believe today that I pay over half my income in income taxes. He said, Congressman, I am not including -- I am not including any other taxes. I am not including payroll taxes. I am not including real estate taxes. I am not including Workers Comp. I am talking over 50 percent of my income goes to the Federal, the State, and local Government. No one helped me when I started my business. I had all the risks. Nobody else shared in the risks. And when you take over half of what I make, I can't grow my business.

And so I look at the bios, Mr. Chairman, and I see three bios of three people who put it all on the line -- and no disrespect, Ms. Huang -- an academic. So it reminds me of when I first started my own business. I was a realtor. First time in my life that I had to write a check every quarter to the IRS. First time. I didn't know that. I never knew that before.

I was starting to work when I was 16 years old. And as a realtor, Ms. Boenigk, I learned the value of uncertainty. That wasn't a very good thing to learn. But I didn't know it as a rank-and-file employee. But as a business owner, as a realtor, the uncertainty of regulations changing at the State, and local, and

Federal level, and the uncertainty of the Tax Code again at the local, State, and Federal level.

And you talked about that unexpected tax bill. I remember my dad telling me when I took my first job at McDonald's, don't let the Tax Code stop you from doing the right thing, and that is continuing to try to make more money, despite the fact that the government is taking this money, my immigrant father, and don't let it stop you from saving and investing, despite whatever the Tax Code might tell you.

And you three have not let it stop you. You haven't let the Tax Code stop you.

My question, Ms. Boenigk, is -- and you have a really great story -- in your written testimony you talked about, and you talked about permanency in your verbal testimony. That certainty and that permanency, what does it mean for you as a small business owner?

Ms. Boenigk. Well, it is very hard to plan when you are looking forward, if you don't know what the Tax Code is going to be. We made a huge, multi-million-dollar acquisition a couple of years ago. And even though there is a $500,000 a year ability to write that off, we didn't have the ability to write off everything because of the fact that it was a multi-million dollar acquisition. And so every year we are dealing with, well, how much depreciation and amortization do we really have? It is close to $400,000 right now. And the interest expense, that is very scary for me. If the interest expense deduction is taken away, I think it will be very much of an impediment to small businesses to go out and take loans out to borrow money to help their businesses if you can't write off the expense, because it is not just what you bought your house for, you buy a $100,000 house, you end up paying $200,000 for it over time because of the interest.

So what I paid for the acquisition and my costs are going to be two very different things because of the interest that I have to pay. So knowing what the Tax Code is going to be and making these things permanent is a big deal.

Mr. Tiberi. Thank you.

Ms. Boenigk. The Tax Code, going back and forth with the State tax a couple of years ago, those are the kinds of things that are just very confusing for small businesses.

Mr. Tiberi. Quick answer, Ms. Meares and Mr. VanderWal, tell me what you think when people say that cutting your taxes only impacts the wealthy. Do you feel wealthy? Is it offensive to compare you with, let's say, a billionaire?

Ms. Meares. Well, I wrote a little note when you said -- I am sorry. I wrote a note when you said it. It was don't focus too much on -- they always say the 1 percent, the minority hurting the majority. And in my testimony I believe I wrote I have met a lot of small businesses, and their owners are not sitting around on yachts. We are all out there in the trenches, with a shovel, digging the hole, trying to make it every day.

Mr. Tiberi. Thank you.

Chairman Roskam. Just quickly, Mr. VanderWal.

Mr. VanderWal. Okay. Thank you, sir. I would just answer that question by saying farms and ranches are always property rich but cash poor. And so I don't feel rich most of the time. I would also say that private business, small businesses, are what built this country and what will continue to make this country prosperous.

Thank you.

Chairman Roskam. Thank you.

Mr. Larson.

Mr. Larson. Thank you. And I agree we have some stellar witnesses today, and I thank them.

I would also add, Mr. Chairman, that I hope -- and I want to echo the sentiments of Mr. Doggett -- that inasmuch as this is our first hearing, I hope that we intensify the hearing so that we have an opportunity to discuss what are very important issues to the American citizens if we are going to get -- and I think Ms. Boenigk said it best. You know, if we are going to have comprehensive tax reform that benefits everybody, it is long overdue, and we have to do it now.

There is great bipartisan cooperation, contrary to a lot of popular belief and what you might hear, and an awful lot all of lot of mutual sentiment that exists on this committee.

So I think both from the perspective of the public hearings, and also the informal hearings that we might be able to have, as well, I think is vitally important if we are going to achieve that goal that we have it this year. Let me -- that we get at it and have more hearings and also more informal discussion as well.

Let me comment, I am a small business owner myself. And so I certainly know what it means to meet a payroll. And certainly I think Mr. Tiberi outlined very well what happens when you are in a small business and the number of decisions that you are confronted with.

Ms. Meares, I particularly was impressed with one thing you said in going through that whole scenario of what that would mean is that it meant for greater growth at the end of the day. And, in fact, paying more in terms of an effective tax rate and employing more people. And that is the engine of small business. That is what it does. And, as all of you have indicated, you are the backbone of the country.

I just want to ask one question. Again, you are going to hear us talk about, on this side, not only that we want a Tax Code that is revenue neutral, but distributionally neutral or fair.

And I think just a yes or no answer -- because I think I can anticipate what the answer will be, you wouldn't want the same thing -- and, as Warren Buffett has said, he wants to make sure in the distribution of taxes that his secretary -- and I am sure it applies to you with all of your workforce -- isn't unfairly impacted by any tax reform. Would that be the case, Ms. Meares? Yes. I am sure that would be the answer, et cetera. And that is why it is also important to have an academic as part of the testimony as well.

So, Ms. Huang, what I would like to ask you in a follow-up to where Mr. Doggett was going, but your sense, so far, given your knowledge of President Trump's tax proposal, how do you think that stands in terms of its fairness? And how do you think that plan will be judged in terms of the fairness in terms of distribution?

Ms. Huang. So the President, in his inaugural speech, said that he would make decisions on tax reform that would focus on workers and American families. And his Secretary of Treasury has said that there would be no net tax cuts for what he called the upper class. Unfortunately, everything that we have seen in terms of actual detailed policy goes in quite the opposite direction.

We are looking at a plan that sends about half of its tax cuts to the top -- you know, to people that have incomes of above a million dollars a year. And many of those tax cuts are focused on large cooperations through this territorial tax system and also top -- cuts on the top rate.

Mr. Larson. Well, I -- you know, and my next-door neighbor is a farmer. They have been farming the same piece of property since the 1640s. Our colleague, Mike Thompson, has a bill that I know he is going to ask you, Mr. VanderWal, a question about, but I, just again, wanted to point out the respect that I have for farmers and all small businesses in general because of what you have to go through. But I hope you can appreciate the deep and abiding concern about the distribution.

As has been mentioned before, and I would again ask from an academic pass-through, are pass-throughs equally distributed? And how do we ensure that the people richly deserving, or who it will have no effect on, get the kind of tax relief that they need and the workforce that they employ, gets the fairness out of the code, not finding that the very safety nets that they rely on, Medicaid and Medicare, are being used to fund a tax cut that you may not necessarily need but goes to advantage the Nation's 1 percent.

Ms. Huang. Absolutely. So the people who would benefit the most, the very highest income households in the country. And we are talking about the top 400 taxpayers who, on average, have incomes of $300 million a year each. Those are the ones that would be receiving tax cuts of 9 million a year.

So this is not very well targeted towards sorts of businesses that are struggling and growing, many of them who have tax rates already below 15 percent, already below 25 percent, which is where the Better Way plan would cut the rate.

Mr. Larson. Thank you, Ms. Huang.

I thank the chairman for allowing her the ability to --

Chairman Roskam. Mr. Kelly.

Mr. Kelly. Thank you Mr. Chairman. First of all, thank you for being here, especially the three business owners. Because I know you are taking time of the out of the day that you would be using to actually make your businesses work. That is something that sometimes people forget about.

But one of the things that I noticed in your testimony -- and I know this. I am also a small business person. I come from the private sector, thank God. Because you would never be able to operate your business the way government operates. It is just impossible to do.

But let me ask you this. Because we all have this partner who participates in almost everything we do, whether it is at the local level, the State level, or the Federal level, we have a partner who is constantly coming in and draining down our revenues.

And I thought it was interesting, Ms. Meares, you said in your testimony: I survived these challenges in my previous business, but I now find myself in the same place growing a small business. The challenges I faced the first time are still very much looming in front of me. I still utilize my tax attorney, and I have a new CPA.

Is there any one of you that does your taxes by yourself?

Ms. Meares. No.

Mr. VanderWal. No.

Ms. Boenigk. No.

Mr. Kelly. Is there any reason why you wouldn't?

Ms. Meares. Lots.

Mr. Kelly. I mean, other than being afraid that you are not paying the right amount. I can just tell you, I have always told our CPA, listen, I want to pay every penny I owe, but not a penny more than that, because the penny I save actually goes into the operation of the business.

The three of you, when it comes to paydays, how many times have you paid everybody else in the organization with the exception of yourself?

Ms. Boenigk. A lot.

Mr. Kelly. A lot? Mr. VanderWal, same? Ms. Meares?

Ms. Meares. Yeah. Absolutely. A lot. And our survey shows that, as well, is that a lot of people will not give themselves a raise and take the cuts.

Mr. Kelly. And the purpose of today's hearing, by the way, is what can we do to effect pro-growth tax reform that allows you to go ahead, looking to the future, and say, you know what, I can do something today that is going to allow me to grow the business. And I am assuming growing the business also includes hiring people, increasing the number of people working for you.

And too many times in our country I think -- you know, we invent great things here, but we manufacture them overseas. Now we don't manufacture them overseas because we don't like the country we live in. We manufacture them overseas because we can't produce them profitably at home. We have actually forced people off our shores and then blame them for leaving. I mean this has been an incredible thing for me to watch.

So when I see what we are trying to do today, say, okay, what could we do today? Because I have got to tell you, I open my own mail at the dealership. And the one thing I always hated opening was anything that had a government label on it. I said, oh, my God, what do they want today, and what are they going to take from me, or what are they going to regulate, and how much is it going to drive the cost of my operation. And that is the thing that I think is stunning.

In addition to the taxes you pay in your profits, would you please explain to other people who other taxes you pay as business owners and as employers?

Ms. Meares. So we pay on the equipment that we purchase. We pay sales tax.

Mr. Kelly. Right.

Ms. Meares. We also pay our local tangible taxes --

Mr. Kelly. Right.

Ms. Meares. -- on the product as well. And then we pay our Federal taxes, and we pay our employee taxes.

Mr. Kelly. Right. So all those employee taxes, by the way, let's just call those wages taxes. And, by the way, we can only take taxes from people that are working. And so we look at a labor force that is not participating at the level it is. And then we say: Why is Social Security failing? It is the revenue stream. When you don't have people putting money in, it is hard to take money out.

Ms. Boenigk, I looked at your story, and it is so incredible. Your dad's thought process put your mother and you in business for yourself. Right?

Ms. Boenigk. Yes.

Mr. Kelly. Started in your garage.

Ms. Boenigk. Yes.

Mr. Kelly. My dad's business started in the basement of our house. That is when he used to service our cars before we would sell them to people.

Mr. VanderWal, you are in the field every day, literally, trying to make a living. But what I am fascinated by is the lack of understanding that the Federal Government, the State Government, our local governments, do not provide one penny of their own money. It all comes from hard-working American taxpayers. And if we don't get people back to work, where is this revenue going to come from? And if we don't allow you to be profitable, where is this revenue going to come from? Is there some magic formula out there that I am not understanding?

So this idea that we can invent and manufacture in the United States makes sense. Makes sense. We are trying to do that with Mr. Kind, by the way. But, if you all, just the burdens you have as business owners goes far deeper than just owning a business. Because you all have a very close relationship with the people that join you every day and looking to have mutual success. Am I right or am I wrong? And doesn't it make you feel good to make payroll?

Ms. Boenigk. Very right.

Mr. Kelly. Yeah. Let me ask you, any of you been able to borrow money from a lender.

Ms. Boenigk. Yes.

Mr. Kelly. -- when things aren't going well?

Ms. Boenigk. Well, you always borrow money before you need it.

Mr. Kelly. Yeah. Well, you know what, that is a good point, with the anticipation you are going to need it. But my understanding and my experience has been, you know, a banker will give you his umbrella when it is sunny, and as soon as it starts to rain, will ask for it back. And that is because they are driven by regulations. They can't do things they would love to do to keep us alive.

But for all of you to be here today is incredible. Please, keep being successful. Keep working with us every day. And please keep hiring people to make sure that we can fund this wonderful system. We have the support system. God bless you for being here. Thank you so much.

I yield back, Mr. Chairman.

Chairman Roskam. And if you ever come back as a witness, you can just say Amen to the chorus of Mike Kelly.

Ms. Sanchez.

Ms. Sanchez. Thank you, Mr. Chairman. And thank you to our witnesses for being with us today. I am particularly pleased to see some female business leaders on the panel today. And I want to begin by associating myself with the comments of our ranking member, Mr. Doggett.

While I am pleased that we are finally having hearings on discrete topics of tax reform, I am frustrated that it took more than half a year to get these going. And I would really urge the chairman to consider Mr. Doggett's proposed list of additional hearing topics, because I think it is important that we do our due diligence.

Before I launch into further remarks, I just have to say, you know, I have heard a lot from the other side of the aisle about how much government takes from businesses in terms of taxes. And while I think that that -- it is very true that we are working on a comprehensive tax reform, I think it is also important to point out what our government gives for those taxes.

So if your business catches on fire, you call the fire department, and that is taxpayer funded. If they are -- you know, you have a -- you have a police force that protects your businesses, that keeps your communities free from crime or as crime-free as they can manage. You have a military that is funded through taxes that protects our country from many threats overseas.

You have a court system. If there are business disputes, you have a court system that is available to you to utilize because of the taxes that you pay into the system. If you provide goods or services, you know, those travel probably via road or possibly rail, also financed through taxes. I just want to make the point that we don't take for the sake of taking. You know, our government needs revenues in order to provide the quality of life that you all enjoy in your jurisdictions.

And while I appreciate very much the challenges that small businesses face and want to do my part to try to help you, I think it is an unfair characterization to say that government simply takes more and more in taxes because it is a fun thing to do or because it is a capricious thing to do. It is a necessary part of living in a civil society. And if you want to see what it is like to live in a jurisdiction that doesn't have infrastructure and government, you know, there are many places around the world that you could go. But I doubt you would want to be in business there.

One of the best parts of my job is when I go back to my district and we do a series of small business walks. And through these walks I get to know not only some really excellent local restaurants and shops but some real true manufacturing gems in my district. And when I sit down with those small business owners, I have an opportunity to have honest discussions with them about some of their challenges and some of the problems that they face. And one of the themes that emerges over and over again is the idea of feeling like they have been left out, feeling like the system is leaving small business owners behind.

Small business owners tell me they are not looking for a handout. They are simply looking for some fairness because they feel like the deck is unfairly stacked against them. And they don't feel like -- you know, like we are considering tax reform in a way that really takes their special needs into account. We seem to be focused on the top, multi-national corporations.

And instead of massive tax cuts for uber-wealthy corporations being balanced on the backs of the true small business owners in my district, they want a little bit of tax fairness. Because if somebody deserves a fairer tax rate, it is those businesses that are the backbones of our communities, not the multi-national companies who are finally bringing back money that they have been stashing offshore. And we shouldn't be giving tax breaks to hedge fund partners so that they can finance another yacht.

I heard earlier that you don't own a yacht. But, you know, some of the people that we are talking about giving tax breaks to do own yachts. And, you know, with the additional money that they are going to be putting back in their pocket, they can buy another one. But squeezing the hard-working people and small business owners in the middle, that has long-lasting impacts on our community.

So I want to see a tax reform that relieves the pressure and lets businesses buy that new machine, or hire that new worker, or put a little bit away towards their retirement.

So in the limited time I have left, I want to ask Ms. Huang, we have heard a lot about how there is a great difference between the maximum tax rate for small businesses as compared to the maximum tax rate for corporations. And if what Congress is really trying to achieve is a level playing field for true small business, can you talk a little bit more about that rate differential and why it is important that we talk about tax rates in terms of effective rather than statutory rates?

Ms. Huang. Absolutely. So the thing to note is that corporations pay that second layer of tax, potentially, when they distribute their dividends. So if you were to cut the top rate on pass-throughs to be the same as the corporate rate, the effective rate for pass-throughs would actually be much, much lower. And, indeed, that is currently why many businesses choose to operate as pass-throughs because of that tax advantage relative to C corporations.

Where the real, I think, imbalance in differential risk is companies like Pfizer that are paying, you know, in the single digits because they can funnel their profits offshore.

Chairman Roskam. Thank you.

Mr. Renacci.

Mr. Renacci. Thank you, Mr. Chairman. I do want to thank you, also, for holding the hearing. I appreciate the witnesses, all of them.

I also was a small business man for almost 30 years. I also started out at age 24 with no money. I also went to a bank. I also borrowed, and I also had to sit at the kitchen table and figure out how I was going to make things then.

Now, the only difference was I was a CPA. So I was able to understand the Tax Code and the complexities of it. But I will also tell you that I still, even understanding the Tax Code, was never really happy. Because after paying all the bills, I also had that partner that Mr. Kelly talked about, which was the Internal Revenue Service that I had to make that payment before I could ever make that payment to myself. And I remember many, many times over many, many years, never taking a payroll and never taking any money just to make sure the business survived so that the employees were able to get the money.

So it comes down to -- I mean, I had the ability of being my own CPA. It was funny. I took a business from two employees to 3,000 employees. And in the end, people used to come in and say: Can I talk to your CPA? And I would say: You are talking to my CPA. Because I did understand the Tax Code.

But for you-all, there is complexities there. And I have said all along, the best thing that can happen is we simplify the Tax Code. And I want kind of get into simplification. Because I do really think that is important. And how we can simplify it, and what we can do better.

I know that, for me, I filed many tax returns even for myself. And I think the biggest one was over 1,000 pages as well. And even I didn't know it. And, by the way, I also had many audits in front of the IRS, and I am not too sure even the IRS agent understood all the pages on the tax return as well. Because it is a complicated system. So it does take a lot of time. It does take a lot of energy. And I think, in the end, we need to figure out how to simplify.

So give me some ideas on what you all do today and where you can see some simplification that would help. I mean, I understand where it might be, but I think my colleagues would like to hear from you.

So Ms. Mears, let me start with you and come across.

Ms. Meares. Well, as you mentioned, I do have to spend a lot of money in order to make sure that I make the tax deductions. And at the end I may not always get, yes, you can deduct that. And so now I have spent the money in trying to figure it out, and then at the end of the day I can't deduct it or I can only deduct a certain portion of it and it still really doesn't do me any good.

So it is a very challenging decision process to make when to research something, or when to study it, or when to trust it. I did have a CPA. Before I said I had a new CPA. There is a reason for that. And I ended up overpaying a lot. I ended up having to hire a tax attorney to find out if I could. And, again, by the time I did figure that out, and I had to go back and amend my taxes, it was -- you know, it was 4 years too late.

And so I don't think any business -- I think we all want to support this country. We all want to partner up with everybody. That is what makes it so great. But no business should fail, and no employer should have to fire someone or not hire someone because they have to spend money on other things involved with it.

Mr. Renacci. By the way, before -- and I do want to talk about taxes because my colleague, Ms. Sanchez, talked about. The other thing that always drove me crazy, she mentioned some things, which are police, fire, courts. Those are all paid by local taxes. You know, when you are spending money from the Federal Government, she only mentioned two things: military and roads. And we should take care of our roads, and we should pay for our military. But the problem is -- I always joke. We send a dollar to the Federal Government. They take 10 cents, and we get 70 cents back. And my constituents say, yeah, you are missing 20. I go, yep, that is the problem. Because the government, sometimes we miss that 20 cents too.

Mr. VanderWal?

Mr. VanderWal. Thank you, Congressman. I appreciate the question. I think for farmers and ranchers, it would come down to really two things. First of all, simplification, and also opportunity cost. On our farm, I prepare all the information that needs to go to our CPA, the person that does our taxes. And then he puts them through the mill, whatever that is, and he prints out our tax form. And he gives it to me and he says: Look that over and see if you see anything wrong, and we will send it in. Okay. So I try to follow it through. I look at the first page and follow it through to the various pages and forms that are referenced there. And I can't even begin to follow it. I kind of -- I consider myself fairly intelligent. But, at the same time, if people can't fill out their own taxes, it is really a sad thing.

And that gets me to my other point, is opportunity cost. We could spend that money that we pay our CPA or the time that I spend upgrading our machinery --

Mr. Renacci. You got to watch that, paying your CPA.

Mr. VanderWal. -- hiring more people, and things like that. And the CPAs, actually, could help us run our businesses better rather than figuring out how to handle taxes.

Mr. Renacci. Ms. Boenigk.

Ms. Boenigk. Between my mom's tax return and mine and the company's tax return, we end up paying about $30,000 a year to get those three tax returns done. So that is one of the main things. And there is silly things like meals and entertainment we can only deduct 50 percent that we have so the other 50 percent actually shows up as income on my tax return and on my mom's tax return. That is --

Mr. Renacci. Thank you for your testimony.

I yield back.

Chairman Roskam. Thank you.

Mr. Thompson.

Mr. Thompson. Thank you, very much, Mr. Chairman.

And many thanks to the witnesses. You guys are doing an outstanding job, and I appreciate the opportunity to hear what you have to say. And I want to echo -- this has been said by a couple of my colleagues here on the dais. Tax reform is important, and I think there is bipartisan agreement that we need to do tax reform.

Personally, I want to see tax reform that does focus on small business and focuses on the middle class. There has been a lot said about, you know, the gazillionaires and the benefits that they get. And I think they are going to get benefits no matter what we do. But the fact of the matter is, working people, small business owners included, I think are a very, very important part of our economy, and our country, and our heritage, and we need to understand that.

I am pleased that there has been a number of things that have been mentioned. And I hope my colleagues heard the importance that the small business owners place on things like Section 179. We have heard from two people that say that they use it. The issue of deductibility of debt financing, the farmer at the dais explained that that is important to him. And I am sure it is important to other folks as well.

The ability to be able to deduct the amount of money that you and your mom pay for your tax attorney or your accountant, that is very much a part of -- important part of small business.

The estate tax -- and I actually didn't know if I was going to mention it. But Mr. Larson put me on the spot. I believe we do need to do something with estate tax. I don't believe repealing it is the way to go. And I have a particular interest in how estate tax treats small business owners and especially family-owned businesses.

And the legislation that Mr. Larson talked about is my bill that would exempt family-owned farms and small businesses from paying estate tax if they inherit the family farm or the family business and continue to operate it as such. If you sell it and move to the Hawaiian islands, then, you know, pay your taxes just like everybody else. You pay taxes if you make your money working. You ought to pay taxes if you make your money because of a transfer of wealth from someone else.

And as Ms. Sanchez says, I spent a lot of time -- I am a small business owner, by the way, and a farmer. We call them ranchers where I live. So I am one. But I also spend a lot of time, when I am home, meeting with my small business people and taking those tours. Something that I hear a lot about is a qualified workforce. And that goes -- that includes higher education. It includes career training. And it includes immigration reform. And that is something that this Congress should be dealing with. I don't know how you all do in the Dakotas. But I know where I farm and the people that I represent, immigration is a huge, huge issue for us. And I think it is the same across all of the States. And those would all be issues that would help small businesses.

So thank you for what you are doing. Thank you for your input. Please keep sharing with us the things that are important to you.

And I have a question for Ms. Huang. It has come up a couple of times now, this experiment that was done in Kansas, and the elimination of all tax on the pass-through business income was a big part of Governor Brownback's issue. And, as I understand it, they found out that this did take money away from all the things -- all the services that government provides: Education, highways, clean air, cops, firefighters, you name it, to the point where they had to repeal it and had to override a veto to do that. Could you add any more insight on that disastrous experiment?

Ms. Huang. I think the genesis of that disastrous experiment was the idea that those cuts wouldn't have to be made at all because there was a promise of immediate economic growth that would be economic nirvana I think was what was promised.

Mr. Thompson. Similar to what the President promised by doing tax reform that would be the biggest and the best since Ronald Reagan?

Ms.Huang. Indeed. And, in fact, responding to some of the very same people who have advised Governor Brownback to do those tax cuts are advising the President on his plan.

So I think that that economic nirvana didn't happen. In fact, Kansas lagged the country in growth. That meant the budget deficits that as you say put pressure on services, investments --

Mr. Thompson. All the services that small business owners, from cops to highway, depend upon?

Ms.Huang. Right. Delaying road repairs, schools having to go to 4-day weeks to close out the year, schools closing early. These sorts of cuts have short-term and long-term damage on communities and businesses.

Mr. Thompson. Thank you.

Thank you, Mr. Chairman.

Chairman Roskam. Mrs. Noem.

Mrs. Noem. I think in response to the situation that happened in Kansas, there were several other things and factors that were occurring in that situation, as well, rather than just the tax situation. So I think we all can agree that that was a little bit more complicated than just tax policy that hit that State.

And history would show that doesn't prove true in other situations and other States that have taken the exact same action.

Mr. VanderWal, I wanted to visit with you a little bit, because you have spent your life in agriculture. I have spent my life in agriculture. And I think the one thing that happens often is people don't understand the volatility that that industry faces. It is not often we get a farmer testifying before the Ways and Means Committee, much less one from my home State. So I appreciate you coming.

But we, as agriculture producers, borrow money to buy land. Then we go back to a bank and borrow money to buy our machinery to farm that land. And then we go back every single year and borrow money again to buy seed, fertilizer, and chemical. And the way I explained it here in D.C., is that then we take that seed, chemical, and fertilizer, we bury it in the dirt, and we hope that that fall we can go back and pick up something to pay our bills.

And so many of those things that impact our income every year are out of our control. If the sun doesn't, shine if it rains too much, if it doesn't rain at all, if you have some kind of a pest problem or other thing that impacts your harvest, it takes a lot of faith to be a farmer, I believe, in this country. But we do it because we believe in providing food and safe and affordable food for this country.

But I am very concerned about the Tax Code because of the amount of money it takes for producers and small business owners to comply with the Tax Code. It is 6 billion hours a year that we spend in this country paying and spending time figuring out our taxes, and over $6 billion, I believe, small business owners pay to pay CPAs to help us pay our taxes correctly. So that is all lost productivity that could go into these businesses.

I would like you to talk a little bit about the burden this places on your son. I am worried about beginning farmers. The average age of farmers in this country is in the late 50s. So we don't have a lot of young people going into the business because of the volatility and factors out of their control. So talk about how a permanent Tax Code -- because there is people on Capitol Hill that are advocating for temporary tax cuts. And I don't believe that that gives us the certainty we need in some of these industries that are so volatile like agriculture.

Often people think about highly leveraged industries, they think about energy, other areas. But agriculture is one of them. And tell me about the challenges that your son faces with being highly leveraged, volatility, how we need permanence in the Tax Code, and what the uncertainty of temporary would do to him.

Mr. VanderWal. Certainly, Congresswoman Noem. I appreciate the invitation to be here.

Yes, it does make it very difficult. My son is 28 years old. And, like I said, he has got a baby girl. And he is hoping to expand his cow herd. He is farming with us right now, but he would like to expand his own operation as well.

Just take a step back to our family corporation. It is a C Corp that was set up in 1970. And, nowadays, that is not the way to set up a farm operation. But

LLCs weren't invented back then. So what we are going through right now is a process where we are trying to buy out one-half of the family because my father and my uncle still actually own the company and try to buy out one-half of the family. And capital gains taxes are just a huge wall in front of us. It is going to take so much cash out of our operation that we don't even know if we can make that work long-term. So that is what he is facing down the road.

You talk about estate taxes. I mentioned that we are underneath the threshold right now for that. But who knows, my son is a very enterprising person. And maybe he and his daughter will get above that threshold someday. And that is still going to be a family farm no matter how big it is.

Ninety-eight percent of the farms and ranches in this country are family-owned and operated. And that is one of the biggest things about that that brings it down to a personal level.

Mrs. Noem. Well, I think that is what you hear. You have heard testimony here today here, as well, about the death tax and how it should continue to remain in place. You know my personal story with that. When I was still going to college my dad was killed in an accident on our farm, and we ended up getting hit with the death taxes very substantially. In fact, we didn't have any money in the bank. We had land. We had cattle. We had machinery, but no money in the bank. So we ended up taking out a loan. And it took us 10 years to pay off those death taxes, which is double taxation. It is an unfair tax.

And even though you say you are underneath the exemption, I am guessing you spend money on estate planning. And even your son is thinking about who he is going to pay to give him expert planning to make sure that he doesn't have to pay death taxes to put him into a situation where he is burdened even more debt.

Mr. VanderWal. Yes. That is a great point. Who knows what the future holds. He is going to do the best he can to build the business. And, knowing him, he might be worth $10, $20 million someday.

Mrs. Noem. Right. Well, and today it is taking more and more acres for one family to be supported anyway. So maybe my grandpa bought land for $50 an acre, but it might be worth $10,000 an acre today. And that is why you hit that exemption so much quicker. Plus, I can't get by on farming 800 acres anymore. I have got too farm 1300, 2,000, 3,000 to pay your bills now. So that is why that exemption just doesn't meet the needs that we have and the entire tax should be repealed.

Mr. Chairman, I yield back. Thank you.

Chairman Roskam. Ms. DelBene.

Ms. DelBene. Thank you, Mr. Chairman, and thanks to all of you for being here with us today.

First, Mr. Chairman, I would like to submit, for the record, a letter from the breweries and wineries. Many small businesses in my State of Washington with their feedback on tax reform.

Chairman Roskam. Without objection, so ordered.

Pending Insert Submission

Ms. DelBene. Thank you so much.

My district in Washington State is home to over 3,000 farms that grow a variety of fruits, and seeds, and vegetables, as well as a number of dairy farms. And I definitely know how critical a vibrant agriculture sector is to the U.S. economy and to the local communities throughout our country that farmers help support.

And I also know that farming is an incredible capital intensive and unpredictable undertaking with large upfront investments that can take a long time to pay off, and affordable financing can be as important to a farm's success as the weather, the sun and the rain.

So Mr. VanderWal, I am hoping you can elaborate a little bit more on what mechanisms are used by America's family owned farms to finance investments in their operations, what role interest deductions play in making that financing affordable, and why it is so important, and what is unique about small agricultural businesses that this committee should keep in mind as we move forward with tax reform.

Mr. VanderWal. Thank you very much for the question. I tried to make some notes here so I get them all.

First of all, investments. You know, we are kind of left with going to the bank for financing. We don't get the attention of Wall Street investors, venture capital type people. Because they look at the returns that farming makes. And, like I said in my original testimony, the returns that we get on a return for investment isn't very good compared to a lot of different businesses and industries.

As far as interest deduction goes, like Mrs. Noem said, everything we do, a lot of times, takes borrowed money until you really get your feet on the ground and expand your operation. And that is a very important part. Farm management specialists tell us that you can use up to 25 percent of your net income to pay interest. And that is a lot of dollars. And So that is why that is so important to us to be able to use those dollars that aren't taken by the government to build our businesses.

Ms. DelBene. Thank you.

Also, I wondered if you would elaborate a little bit about the importance of like-kind exchanges to farmers. I know we often talk about this in terms of real estate, but I also wanted to ask you about equipment. Because we know that now you might be wanting to upgrade farming equipment, especially with newer technologies. You might have a tractor that has -- that is internet connected that might be able to provide feedback to help you optimize your crop yields. And so can a 1301 exchange help a farmer make that upgrade? And how would that happen?

Mr. VanderWal. Yes. That is very important for us. I think it is more used in land trading -- or I shouldn't say trading, but land transactions. Think about all our cities with urban sprawl where they are expanding out into farm territory. And there are farmers who literally get pushed out of existence by this kind of activity. So when they can use a 1031 exchange to sell that land that is close to a city and then go out, further out in the country, and buy land, that enables them to keep farming rather than having to just sell out their land and go find a different enterprise.

So it is very important. Machinery, it is used to some extent, I think a lot of times by nonfarm companies more so than farms. But it is something that is used, and it is important in making those transactions.

Ms. DelBene. Thank you.

Ms. Huang, in your research, we have talked a lot about what we can do to help small businesses. In your research, you pointed out very plainly that only .003 percent of all estates, that is three out of every one hundred thousand people who might pass away this year, will be small businesses or farm estates that owe any estate tax. And we talked a lot about the estate tax.

But I wanted to know what your feedback would be, especially for small farms, true small business owners, who aren't part of that top few who want to make sure that in tax reform we look at what we can do to benefit small businesses and what things you think we should prioritize?

Ms.Huang. Thank you.

I have heard a lot about the need for simplification and permanence, and I think those are all really important areas to look at within tax reform.

I think my main concern, however, is that it is a little bit premature to be talking about some of these really important pieces if we have set ourselves up in a framework where small businesses, small farms, ordinary American workers, could, in fact, be picking up the tab for large tax cuts that are flowing overwhelmingly to people at the very top and corporations that are already paying very low rates.

So that is my overarching concern with tax reform, that we first get ourselves in a situation where we are not doing harm, and then we can talk some more about these simplifications, permanence. That would all be very important.

Chairman Roskam. Thank you.

Ms. DelBene. I'm sorry. I ran out of time. I yield back, Mr. Chair.

Chairman Roskam. Mr. Holding.

Mr. Holding. Thank you, Mr. Chairman.

I will remind our colleagues that over the past couple of years we have held many hearings, and we have meeting with our constituents where we have heard from witnesses, constituents, stakeholders across all business sectors. And they all say the Tax Code is outdated, overly burdensome, and places U.S. companies at a competitive disadvantage. And yet for 30 years we have not managed to overhaul the Tax Code.

With a worldwide tax system and the highest corporate tax rate in the industrialized world, which, as our witnesses have pointed out, there is even a higher rate for small businesses, pass-throughs. We are continuing to slog along under the status quo all while letting foreign countries use our broken code against us to attract business investment and once-American jobs, jobs that were once here in America.

So our current worldwide system taxation makes it more attractive to be headquartered in a foreign tax jurisdiction. So American businesses, in order to remain internationally competitive, are forced to move their business operations and jobs overseas.

And, further, not only does our broken Tax Code encourage jobs to be moved overseas, at the same time it discourages Americans from -- individual Americans from competing for jobs in foreign countries due to our abnormally unique system of citizenship-based taxation.

So, now, Mr. Chairman, we have a prime opportunity, this session of Congress, to reform the code. And it is imperative, I think, that we act quickly to put in place a new code that allows businesses and citizens to equally and adequately compete on the global stage.

So, Ms. Boenigk, I would like to address a question to you. I was listening to your testimony. In your testimony you talked about the need to level the playing field for American businesses. And as you were the owner of a business that serves international markets, I would like for you to describe how our Tax Code has impacted you as compared to your foreign competitors and how they are at an advantage.

Ms. Boenigk. Well, the complications with our Tax Code do make it a little more difficult. For example, we pay estimated taxes every quarter. And so we pay -- you have to pay your taxes in June for the second quarter, June 10th. So I am guessing what I am going to make in June and what my taxes need to be paid for that point. So that is one of the things that is an issue.

As far as the foreign competition goes, we are seeing more and more furniture that is coming from -- especially from Asia. And the problem with that is that, obviously, their workforces get paid much less. They don't have any environmental issues that they deal with because they just pollute everything. But those products come into our country and there is no tariffs or taxes on them at all. And so they can bring in a product that is much lower cost than what I can manufacture it here in the United States. And that is one of the things that we have to compete with day in and day out.

Mr. Holding. So what you are pointing out is foreign competitors, when they are exporting goods to the United States, they are not paying income tax in their own jurisdiction, and there is no, as you point out, taxation of that good to put it on a level playing field with the taxes that you are paying here in the United States. So you are paying tax, they are not paying tax.

Ms. Boenigk. Exactly.

Mr. Holding. So when you are coming up with the cost of the goods and the profit, you are at a distinct disadvantage.

Well, I want to thank all of you all for your testimony here today. And I believe every member of this committee, and every Member of Congress, owes it to you, and the more than 28 million other small businesses in this country, to get permanent, progrowth tax reform done. And I hope you hold us to that.

So thank you. I yield back.

Chairman Roskam. Mr. Marchant.

Mr. Marchant. Thank you, Mr. Chairman.

Ms. Boenigk, you are a fellow Texan. Welcome to Washington.

Ms. Boenigk. Thank you.

Mr. Marchant. We are also privileged to be in a State that has no State income tax, which would --

Ms. Boenigk. Very much appreciated.

Mr. Marchant. -- really complicate your business I am sure. I don't know about South Dakota and --

Ms. Meares. No.

Mr. Marchant. Okay. So we have got a very privileged panel today, all come from States with no State income tax.

So you can see how exasperating this would be if you -- if your businesses had another layer of tax added to it. And most of the States that are represented in Congress have that additional layer. And it makes Federal tax reform for small businesses even more important.

I think, Mr. VanderWal has told us -- you operate as a C Corp.

Mr. VanderWal. Yes.

Mr. Marchant. Do you mind telling us, the other two witnesses, how you operate?

Ms. Meares. My current business is an LLC, and I operate as an S corp.

Ms. Boenigk. We are on S corp.

Mr. Marchant. So your accountant advised you how to form those. Is there a particular reason why either of you or both of you decided on that?

Ms. Boenigk. When we originally started the company, we started as a C corp because that is what the lawyer told us to do. We didn't really understand the difference. And it wasn't until -- we actually took the company public in 1997, and then took it private again in 2001. When we took the company private again, we formed as an S corp because at that point we knew that that was a much better tax position to be in to establish the company that way.

So we have been both. But the S corp seems to work better.

Ms. Meares. I agree. The S corp definitely works better for us, and we were advised by our CPA and attorney as we set it up. I actually had a bad experience as a C corp when I purchased a distributorship. And so I also recognized that if I wanted an exit strategy, trying to sell it out, it would also make it a lot more challenging for it to be a C corp instead of an S corp. So I was looking at my exit as well.

Mr. Marchant. So to each of the business owners, what is the single most frustrating thing that you deal with on a regular basis as it pertains to the Tax Code? What is the thing that drives you the craziest about the Tax Code?

Ms. Meares. I guess a simple answer would be to have to depend on other people to hope that they are right, and having to spend money not knowing if that is really going to give me a return on it because it is so challenging and difficult. And the fact that I have paid, overpaid, on taxes due to that, makes it even more frustrating and scary.

Mr. Marchant. So the complexity of it?

Ms. Meares. Complexity.

Mr. Marchant. Mr. VanderWal?

Mr. VanderWal. Yes, sir. I would say, first of all, the tremendous amount of money and cash, that transferring our operation from one generation to the next is going to take out of our operating fund and also the incredible complexity of the Tax Code.

Ms. Boenigk. I think the complexity is the biggest issue. I always thought that accounting was very black and white, and it wasn't until I started dealing with the tax accountants that I found that there is this whole gray area. And it is do you categorize it as this or do you categorize it as that.

And, again, when I look at my tax return for a certain certification last year, I had to be able to prove what my individual income was versus any income that my husband had on our tax return. And I had to go back to my accountant and have them do a spreadsheet. Because as an S corp there are things like the R&D credit that end up on my tax return. Well, I don't know if that is income or a deduction.

So it is just so complicated that you can't even understand what this document is that you are signing, and you are counting on other people to put this together, and then you sign it in hopes that you don't get audited, or get in trouble, or have, you know, something bad happen.

Mr. Marchant. And it really exasperates things when Congress has to meet every 2 years and renew certain aspects of the Tax Code through extenders, which this committee does not enjoy doing.

And would each of you mind telling me, this panel, who are your largest customer base? Are they big corporations? Is it other small businesses? Who do you sell most of your stuff to?

Ms. Meares. My largest customers right now are State, city and local government agencies. So I do uniforms. So any, you know, police officers, fire and rescue, public safety.

Mr. Marchant. Mr. VanderWal?

Mr. VanderWal. We feed most of our corn to our cattle through our feed lot. Our soybeans go to a local processer that we are a very small part owner in. And the cattle go to the major packers.

Mr. Marchant. Okay.

Ms. Boenigk. About 20 percent of our business is actually with the Federal Government. We have a GSA contract. So we love the fact that the government does spend some money on buying furniture. The rest of it is primarily Fortune 500 businesses.

Mr. Marchant. Thank you.

Chairman Roskam. We will now hear from first-time caller, long-time listener, Mrs. Walorski.

Mrs. Walorski. Thank you, Mr. Chairman. Thanks to the panel for being here as well.

This has been such a fascinating discussion. I am so grateful, especially the three of you that are running small businesses came in, all the way in here, as Representative Kelly talked about.

I am fascinated, though -- I have to just bring this to everyone's attention -- in Ms, Huang's written testimony, Figure 2 here, says: Trump-like pass-through rate cut would not benefit low and middle-income Americans. And I am sitting here listening to this testimony, and I am thinking, this is one of these issues where it looks like we can't see the forest for the trees because of this glaring 1 percent.

I want to ask all three of you that are actually running businesses: How many employees do each of you have.

Ms. Meares, just start here and just go down the line.

Ms. Meares. So total right now is 15 as I just hired five in the last 6 months.

Mrs. Walorski. Mr. VanderWal?

Mr. VanderWal. We employ five family members and a couple of part-time college kids on our farm.

Chairman Roskam. Ms. Boenigk?

Ms. Boenigk. We have almost 90 at the factory in Texas. And then we have independent reps across the country and in Canada. So 60 more that we pay on a 1099 basis.

Mrs. Walorski. Are any of your employees in a category that would be in that 1 percent of rich Americans?

Ms. Meares. No.

Ms. Boenigk. Neither are we.

Mrs. Walorski. Would tax reform allow you to pay more people more money, hire more people? And if you hire more people, do you think you will hire people that are in that 1 percent rich or is it going to be average, middle-class Americans?

Ms. Meares. Average.

Ms. Boenigk. Average, middle-class Americans.

Mrs. Walorski. I think that one of the things we miss when we sit on these committees is all the statistical information that comes out, the can't see the forest for the tree kind of things. But, I mean, what I hear today from all of you that have employees, that you are actually engaged in this every day, is that a pass-through rate cut raises all ships. And when all ships raise in this country, that is how we get the most efficient, accurate, you know, increase in money and productivity in the lower and middle-income in this country. Because all ships rise.

So, you know, as we have been looking at this in a way to come in and be the most benefit to you, I see this headline as being very blinded to what we have heard here today that we are not having a discussion about the House budget plan, the Trump-like tax reform plan. We are not having a discussion about the 1 percent. We are talking about energizing a growth factor in this country that will literally spark an economy where all ships rise and they do it quicker and not slower.

Because what I think it does is answer the question is -- I mean, what I have heard from you today is this tax reform plan has to be permanent. This tax reform plan has to raise all ships in this country. It can't be a -- you know, concentrated on 1 percent. I think we have proven today, in all of your testimony, the reflection of the hard work, the risks that you take. The risk that is taken by small business in this country is unparalleled because there is no backstop. There is a backstop to everything that we do here. And it is hard-working taxpayers' money.

But the backstop that you seem to be asking us for is a tax reform that works for you, not against you. It works for your future employees, not against them. It allows all ships to rise in this country, and that the expediency should be on our part to urgently move this legislation. Would that not be the summary of what we have heard today?

Ms. Boenigk. That would be wonderful.

Mrs. Walorski. I very much appreciate it. I appreciate your hard work.

Thank you, Mr. Chairman. I yield back.

Chairman Roskam. Mr. Rice.

Mr. Rice. Thank you, Mr. Chairman.

Mr. VanderWal, you raise corn, and soybeans, and cattle from what I understand?

Mr. VanderWal. Yes, sir.

Mr. Rice. Is any of your product exported?

Mr. VanderWal. Yes, I am sure it is. We don't track it because a lot of our beef goes to the major packers. But certainly that is. There are certain markets that we cater to that are for exports like the implant free and things like that.

Corn is also something, some goes to ethanol plants. But the dried distillers grains are exported as well.

Mr. Rice. You know, we had the chairman of Archer Daniels Midland here a couple of weeks ago, and he was talking about the fact that the Midwest of this country, where you are located, provided 80 percent of the world's grain exports 30 years ago. And certainly technology has improved around the world.

But our Tax Code makes us very uncompetitive in the world. And my goal in Congress -- my goal in tax reform -- tax reform is one of the primary reasons I came to Congress -- is to make our country competitive. Because I think American workers and American companies can compete with everybody in the world if we are on a level playing field. And we are not.

So when we are competing against Ukraine and Brazil on grain exports, and we were providing 80 percent 30 years ago, and now Ukraine and Brazil have border adjustment through value added taxes, so their grain and exports are 15 percent cheaper than your grain. Do you think China is going to pay 15 percent more for your grain than they are for Ukrainian grain or Brazilian grain?

So when we look at the fact that our market share worldwide has dropped from 80 percent to 40 percent in the last 30 years, we really shouldn't be surprised.

Ms. Boenigk, is that right?

Ms. Boenigk. Yes.

Mr. Rice. Do you export?

Ms. Boenigk. A little bit to Canada. Most of our other exports go to Air Force bases and Army bases across the world. So those are really still going to U.S. soil just because they are in Japan or Germany.

Mr. Rice. So you are having to pay a border adjustment when your product goes into Canada, which makes your product more expensive compared to Canada furniture makers, right?

Ms. Boenigk. Yes.

Mr. Rice. Which puts you at a competitive disadvantage. I think Canada's border adjustment is about 9 percent if I recall. So either you have got to accept 9 percent less for your product or you are going to get that much less sales. So you are at a huge disadvantage. Do you compete in the American market against imported goods?

Ms. Boenigk. All the time.

Mr. Rice. Yeah. And they are coming from China and all over the world. And they have -- you know, China's border adjustment is between 15 and 20 percent. So you are at a 15 to 20 percent disadvantage because we have a tax system, purely income tax system, at a very high rate, that puts you at a huge disadvantage. It is fascinating to me that you have been able to build this business as well as you have and continue to compete against this, in my opinion, unfair burden that has been placed on you by our Tax Code.

What if we did away with that 15 percent disadvantage? What do you think the result would be on your business?

Ms. Boenigk. I think that in some ways it would be very helpful. I assume you are talking about the Border Adjustment Tax.

Mr. Rice. Well, Let's say we did it through any mechanism, through a VAT, through a BAT, through anything else, we just eliminated the 15 percent price differential where you are competing with Chinese goods. Would that affect your sales?

Ms. Boenigk. I think from the overall standpoint that would be good. The issue that we have is that because we have made it so non-competitive in the United States, there are some things that you can't buy in America anymore. Like the wheels on your chairs, the casters. You can only buy those pretty much in Asia anymore.

Mr. Rice. But if it became competitive in the United States again, you think people would start making wheels in the United States?

Ms. Boenigk. I think so. I think it just has to be phased in so that you give companies the time to actually bring those jobs back and to manufacture those products here.

Mr. Rice. Ms. Meares, do you export?

Ms. Meares. I do not.

Mr. Rice. Do you sell to people who export?

Ms. Meares. I do not.

Mr. Rice. Who do you sell to?

Ms. Meares. I sell to mostly local city, State, and county governments, and then I have private companies that also -- that wear uniforms as well. So clothing. So it is all --

Mr. Rice. Do those people buy uniforms from, say, China, or from other places in the world?

Ms. Meares. Absolutely. Yeah. And, you know, to try to get an American-made product and be competitive is almost nonexistent.

Mr. Rice. Because our Tax Code puts you at a -- you know, because we don't have border adjustment. We have a pure income tax higher rate. You are at about a 15 percent disadvantage. Let me ask you this. If you could cut your prices by 15 percent and lower your cost by 15 percent, would that affect your sales?

Ms. Meares. Absolutely. And I think a lot of people in my industry, on the clothing industry, we do have, you know, USA, made in the USA, and we try to do it. But, consistently, it is always higher price. And that is, if you talk to the customers alone, that is their, oh, it is made in the USA. Okay, well, I am going to have to pay a little more. Some are like, okay, I will. But then others are like, no. It ends up being on the price.

Especially, you know, at the end of the day, and when you are doing a bid, they look at that bottom number. You know? And when yours is a lot higher because you can't compete with the cost of goods and you are just trying to make a margin, it is --

Mr. Rice. Well, I appreciate all you all being here. I -- my sole focus is making our country competitive. If we go through this exercise of reforming our Tax Code, which we desperately need to do, and we don't make us -- the result is not that we are the most competitive economy in the world, then shame on us.

Thank you very much.

Chairman Roskam. Thank you all.

Let me make a couple of observations and kind of clean up here as is the chairman's prerogative.

So, first of all, thank all four of you for your time and your willingness to engage us. My request of you is that when you go back and you have a discussion with people, tell them, huh, you witnessed something very interesting, that was a bipartisan, civil discussion where people brought different perspectives, it didn't involve anybody snarling at one another on television, or questioning one another's motives. What a refreshing, what a delightful experience. So thank you very much for coming.

Let me make a couple of observations. I think that there are some things that going on in this tax discussion that are actually fault lines. And you can sort of sense them. And we have got to figure them out. The American public has to figure these things out.

One fault line is: Do we have a permanent Tax Code or don't we have a permanent Tax Code? And for the small business owners that we heard from today, they all said, yeah, give us permanence. Ms. Huang said, give us permanence. But there are voices out there that are sort of a little bit of a siren song, saying, oh, just deal with a temporary thing and get permanence down the road. I am of the view that we are at an inflection point right now, we have got to deal with this, and let's have a permanent code.

The other issue that has got to be sorted out, and it sort of -- it raised to the surface -- not explicitly, but you can get this sense that there is this notion of some folks in the tax debate view the economy as a fixed pie. That is, if somebody does well, it has to come at the demise of somebody else. It can't be that somebody is doing well because they brought a new product to the marketplace, or something is competitive and through virtue and hard work. It has to be a nefarious enterprise.

We have got to sort that out. That is not in sync with who we have been, historically, as a people. I mentioned this in my opening statement, and that was we have historically not been a jealous people. And I am telling you, that is really part of the charm of the American economy. And we have got to sort that out. Because if this becomes a zero sum game debate, it becomes really unsatisfying. It just doesn't end well for anybody. So enough said there. But we have got to sort through these two fault lines.

These larger themes, though, particularly as it relates to the blueprint, even Mr. Doggett, in some of his initial comments, he would find no objection in these things. He may put an emphasis on other things, as well, but he would find no objection in several of these themes. First is, we are proposing real growth, growth that is buoyant. I see my friends from Local 17, the insulators, from the Chicago area that are here today. And I visited their facility a couple of weeks ago. What do their members want? Well, what their members want is an economy that is growing, that is expanding, that they can go out and insulate things and so forth. So growth matters. And the ripple effect throughout the whole economy is incredibly profound.

The second thing is, we need a simpler code. I mentioned this earlier. But this notion that somehow we view the Tax Code as something that is just insurmountable is a false claim. We can deal with this. And two of you both cited the level of complexity at the beginning of your businesses that became really overwhelming and could have put you under. So let's get to that.

We didn't really have this larger discussion of one of the third themes, and that is we have got to deal with the erosion of the tax base. That is when customers leave, it is devastating. Or when we import deductions into our tax framework, it is devastating. We don't have to live like this. Let's fix it, and let's deal with it.

And then the fourth thing I mentioned earlier, and that is permanence. So I think there is -- we need to navigate through these fault lines. We need not be distracted by all the drama that this town entails, just sort of turn off the televisions and just focus in on driving toward these conversations.

And I think a couple of things. One thing that is important is we are hearing from small businesses who are concerned about their ability to deduct their interest on business expenses. Message received. We are actively working on that. And I think that we are going to get to a good place on that.

We are also very mindful of some of the concerns in terms of anti-abuse rules on the pass-through treatment. Message received. We need to understand that so that it can't be manipulated. And I get the irony that we are advocating a level of complexity while we are arguing for simplicity. I get the joke. I got it. But we have got to navigate our way through that.

There is also some insight that came from Mr. Thompson. And I don't want to quote him in his absence. But I will sort of paraphrase. He said the super wealthy are going to do well no matter what. And, hey, and the super wealthy are doing well today. So this notion that -- you know, to follow up on Mrs. Walorski, let's not be blinded by where they are. Yeah. Let's be attentive to it. Let's be mindful of it, but let's also realize that we have got a real responsibility for folks up and down the entire economic chain.

And then I have just got to tell you, I come from the State of Illinois. And the State of Illinois recently made a very bad decision. The State of Illinois said, rather than dealing with the underlying problems in the State budget, the legislature, over the Governor's objection, jammed through a massive income tax hike. And here is what happens. People are leaving Illinois, and they are going to places like Texas. They are going to places that are far more attractive from a tax point of view. So we have got to be aware of the holistic and the totality -- the holistic nature of this tax debate.

And let me just make one final point. If healthcare has an impact on one-sixth of the economy, which it does, tax reform has an impact on 100 percent of the economy. And if you are having an impact on 100 percent of the American economy, you are having an impact on the entire globe.

So it is not lost on the members of this committee, on both sides, that the nature of what we are talking about, the opportunity here, to do something really transformational from a generational point of view, is incredibly significant, which is why your insight, in particular, today, you witnesses, all four of you, we are really deeply appreciative. And we thank you.

And with that -- almost, hold on. Please be advised -- because I know you are just waiting with baited breath -- members will have 2 weeks to submit written questions to be answered later in writing. Those questions, and your answers, will be made part of the record.

With that, the subcommittee stands adjourned.

[Whereupon, at 11:57 a.m., the subcommittee was adjourned.]

PUBLIC SUBMISSIONS FOR THE RECORD

July 27, 2017

The Honorable Peter Roskam
Chairman
House Committee on Ways and Means
Subcommittee on Tax Policy
2246 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Lloyd Doggett
Ranking Member
House Committee on Ways and Means
Subcommittee on Tax Policy
2307 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Roskam and Ranking Member Doggett:

We write to thank the House Ways and Means Subcommittee on Tax Policy for holding a hearing on *How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs* on July 13, 2017. Our companies and organizations share the common goal of pursuing tax reforms that will grow our economy and create jobs. To that end, we welcome the opportunity to highlight the positive contributions of tax incentives for energy efficient investment. In particular, the Section 179D tax deduction for energy efficient commercial and larger multifamily buildings has leveraged billions of dollars in private capital, resulted in energy efficient enhancements to thousands of buildings, and created and preserved hundreds of thousands of jobs since its inception. Reforms to Section 179D can boost these economic fundamentals even more.

These benefits are confirmed by a recent economic impact study conducted by Regional Economic Models, Inc. ("REMI"), the executive summary of which is attached to this statement as an appendix. REMI's conclusion is unequivocal, finding that *"**Section 179D is an engine of economic and employment growth**."* In particular, an enhanced tax incentive for energy efficient commercial buildings, including reforms geared toward retrofits of privately-owned buildings, could support up to **76,529 jobs and contribute almost $7.4 billion toward our national GDP each year.** These results represent a significant return on the taxpayer investment in Section 179D, well in excess of the provision's revenue cost.

The study also confirms that extending the current version of Section 179D or making more modest changes to the incentive would have a substantial positive impact on economic and employment growth. We encourage you to review the study in its entirety, by following this link.

We urge you to keep the economic impact of Section 179D in mind as you consider comprehensive tax reform. Section 179D's proven ability to support economic growth and job creation aligns with the Committee's goals for tax reform. We look forward to working with you to ensure that tax incentives for energy efficient investment continue to be an engine of growth for our economy. Thank you for your consideration.

Sincerely,

Air Conditioning Contractors of America
Alliantgroup, LLC
Ameresco

American Council of Engineering Companies
American Institute of Architects
American Society of Interior Designers (ASID)
APPA – Leadership in Educational Facilities
BLUE Energy Group
Building Owners and Managers Association (BOMA) International
CCIM Institute
Concord Energy Strategies
Consolidated Edison Solutions
Daikin US Corporation
E2 (Environmental Entrepreneurs)
Energy Optimizers, USA
Energy Systems Group
Energy Tax Savers, Inc.
Entegrity
Green Business Certification Inc.
Institute of Real Estate Management
Insulation Contractors Association of America
Johnson Controls, Inc.
Lexicon Lighting Technologies
LightPro Software, LLC
LuNex Lighting
Micromega Systems, Inc.
National Apartment Association
National Association of College and University Business Officers (NACUBO)
National Association of Electrical Distributors
National Association of Energy Service Companies (NAESCO)
National Association of Real Estate Investment Trusts (NAREIT)
National Association of State Energy Officials (NASEO)
National Electrical Manufacturers Association (NEMA)
National Multifamily Housing Council
National Association of REALTORS®
National Roofing Contractors Association
OpTerra Energy Services
Plumbing-Heating-Cooling Contractors—National Association
Polyisocyanurate Insulation Manufacturers Association (PIMA)
PowerDown Holdings, Inc.
PowerDown Lighting Systems, Inc.
Rampart Partners LLC
The Real Estate Roundtable
Sheet Metal and Air Conditioning Contractors' National Association (SMACNA)
Sustainable Performance Solutions LLC
U.S. Green Building Council

Analysis of Proposals to Enhance and Extend the Section 179D Energy Efficient Commercial Buildings Tax Deduction

Prepared by Regional Economic Models, Inc. (REMI) May 2017

Executive Summary

Section 179D of the Internal Revenue Code, the Energy Efficient Commercial Buildings Deduction, was originally enacted by Congress as part of the Energy Policy Act of 2005 to promote energy independence. Section 179D promotes the proper allocation of incentives in the real estate development process. A key challenge to realizing the benefits of energy-efficient improvements is that the associated cost savings flow to building occupants, not developers. By helping offset the cost of energy efficient investments, Section 179D allows building owners to share in the incentive to install energy-efficient improvements that help their occupants save money on electricity, water, and climate control costs. In so doing, Section 179D promotes private-sector solutions to improve conservation practices and modernize national infrastructure.

In this analysis, REMI evaluates the economic impact of three potential approaches to the Section 179D deduction, which most recently expired at the end of 2016:

1. **Strengthening and Modernizing Section 179D**,[1] which would increase the value of the deduction to $3.00 per square foot from $1.80, increase the applicable energy efficiency standards, make it available to support improvements to existing as well as new buildings, and extend the deduction.
2. **Extension of Current Law Section 179D plus Expansion to Non-Profits and Tribal Governments**,[2] modeled on 2015 legislation developed by the Senate Finance Committee under Chairman Orrin Hatch (R-UT), which would extend the deduction, expand availability of the deduction to nonprofit organizations and tribal governments and increase the applicable energy efficiency standards.
3. **Extension of Current Law Section 179D**,[3] modeled on the two-year extension of current law enacted as part of the Protecting Americans from Tax Hikes ("PATH") Act of 2015.

The results of this analysis show that in addition to advancing the goal of energy independence, **Section 179D is an engine of economic and employment growth**. As captured in the table below, this study quantifies these impacts, finding that:

- Strengthening and extending the Section 179D Energy-Efficiency Commercial Buildings Deduction will create jobs and expand the nation's economy. These benefits would be compounded by increasing the dollar value of the deduction in accordance with several Congressional and administration proposals.

- These enhancements to Section 179D would support up to 76,529 jobs annually and contribute annually almost $7.4 billion to national gross domestic product ("GDP"), as well as over $5.7 billion towards national personal income.

- Expanding the availability of the deduction to nonprofit organizations and tribal governments, while increasing the applicable energy efficiency standards, also provide clear positive impacts to the economy.

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[1] Proposals along these lines include Title I of S. 2189, sponsored by Senator Cardin (D-MD) in the 113th Congress and the President's FY 2017 Budget Proposal. *See* Description of Certain Revenue Provisions Contained in the President's Fiscal Year 2017 Budget Proposal, Joint Committee on Taxation, July 2016, JCS-2-16.

[2] *See* Description of the Chairman's Mark of a Bill to Extend Certain Expired Tax Provisions, July 17, 2015, JCX-101-15, and Description of the Chairman's Modification to the Chairman's Mark of a Bill to Extend Certain Expired Tax Provisions, July 21, 2015, JCX-103-15. In addition to the Senate Finance Committee extenders bill, other proposals

Table 1. Average Annual Economic Impacts for First Ten Years

	Strengthen and Modernize	Extension plus Expansion	Extension of Current Law
Jobs	76,529	39,388	40,749
GDP (millions of dollars)	7,398	3,730	3,860
Personal Income (millions of dollars)	5,729	3,017	3,128

ADA American Dental Association®

1111 14th Street, N.W.
Suite 1200
Washington, DC 20005

T 202.898.2400
F 202.898.2437
www.ada.org

July 13, 2017

The Honorable Peter Roskam, Chairman
Subcommittee on Tax Policy
House Ways and Means Committee
1136 Longworth House Office Building
Washington, D.C. 20515

The Honorable Lloyd Doggett, Ranking Member
Subcommittee on Tax Policy
House Ways and Means Committee
1139E Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Roskam and Ranking Member Doggett,

I am writing to you on behalf of the more than 161,000 dentists who are members of the American Dental Association (ADA). We are reaching out to you in advance of your July 13 hearing, "How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs" to provide you with ADA's policy priorities regarding small business tax reforms. The ADA applauds your efforts to improve our current tax system to make it simpler, fairer, and more growth-oriented. The Association looks forward to working with you in the coming months to achieve comprehensive reform of our nation's tax code.

For the most part, dental offices are small businesses. Some are organized as pass-through entities or S Corporations, others as C Corporations. For this reason, our interests straddle both the business and individual portions of the tax code. Below is a brief overview of the tax-related matters that are of highest importance to dentists and our patients.

1. **Cash Accounting:** ADA supports the continued use of the cash method of accounting for small businesses, including pass-through entities and professional service corporations. The cash method of accounting is a simpler, fairer system for dentists who often must wait a significant period of time before being reimbursed by insurance companies for the services they provide. In addition, dentists, particularly orthodontists, frequently provide patients with extended payment plans for services, which delays payment for work performed.

2. **Pass-through Entities:** ADA supports the fair treatment of business income generated by pass-through entities. As previously stated, many dental practices are organized as pass-through entities. As Congress looks to reduce the tax rate on C corporations, ADA encourages you also to consider a rate reduction for S corporations or pass-through entities that are taxed at the individual rate.

3. **Higher Education Incentives:** Dentists just starting a practice today are saddled with an average of $261,149 of student loan debt. This debt impacts their practice decisions, including whether to work in research, dental education, or in underserved areas. It also affects their ability to provide charitable care or pursue post-doctoral education. ADA encourages lawmakers to consider measures that would help relieve this significant debt load when considering options for streamlining the current patchwork of higher education tax incentives.

4. **Use of Pre-Tax Dollars for Health Care:** ADA supports expansion and increased flexibility of health savings accounts (HSAs) and flexible spending accounts (FSAs), as well as preservation of the current tax exclusions for employer-provided medical and dental plans. Specifically, the Association supports returning the FSA limits to the pre-ACA level of $5,000 and continuation of the index to inflation provision. Currently, FSA reimbursement is limited to $2,550 for 2017. The ADA believes the reduced amount is a step back for consumers when the cost of health care continues to increase and adversely impacts the patient's choices for dental care.

Thank you again for the opportunity to comment on tax issues of importance to dentists and dental patients. Please do not hesitate to contact Megan Mortimer, Congressional Lobbyist for the ADA, at 202-898-2402 if you or your staff have any questions or would like additional information.

Sincerely,

Gary L Roberts, DDS

Gary Roberts, D.D.S.
President

Kathy O'Loughlin

Kathleen T. O'Loughlin, D.M.D., M.P.H.
Executive Director

Statement of the American Farm Bureau Federation

SUBMITTED FOR THE HEARING RECORD
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TAX POLICY

"HOW TAX REFORM WILL HELP AMERICA'S SMALL BUISINESSES GROW AND CREATE NEW JOBS"

JULY 14, 2017

Submitted By:
The American Farm Bureau Federation

600 Maryland Ave. SW | Suite 1000W | Washington, DC 20024 | p. 202.406.3600 | f. 202.406.3606 | www.fb.org

The American Farm Bureau Federation is the country's largest general farm organization, with nearly 6 million member families and representing nearly every type of crop and livestock production across all 50 states and Puerto Rico. Our members grow and produce the food, fiber and fuel that propel our nation's economy as well as putting food on our tables. According to USDA, 11 percent of U.S. employment comes from the agriculture and food industry, accounting for 21 million jobs of which about 18 million are off-the-farm positions.

Federal tax policy affects the economic behavior and well-being of farm households as well as the management and profitability of farm and ranch businesses. Farm Bureau supports replacing the current federal income tax with a fair and equitable tax system that encourages success, savings, investment and entrepreneurship. We appreciate the opportunity to file this statement explaining the importance of tax reform and highlighting tax code provisions important to the long-term financial success of farm and ranch businesses.

Farms and ranches operate in a world of uncertainty. From unpredictable commodity and product markets to fluctuating input prices, from uncertain weather to insect or disease outbreaks, running a farm or ranch business is challenging under the best of circumstances. Farmers and ranchers need a tax code that recognizes the financial challenges that impact agricultural producers. They want a simpler, more transparent tax code that doesn't make the challenging task of running a farm or ranch business more difficult than it already is.

Farm Bureau supports tax laws that help the family farms and ranches that grow America's food and fiber, often for rates of return that are modest compared to other business opportunities. What is needed is tax reform that supports high-risk, high-input, capital-intensive businesses like farms and ranches that predominantly operate as sole proprietors and pass-through entities. We believe that tax reform should be equitable and designed to encourage private initiative and domestic economic growth.

Farm Bureau commends the Committee on Ways and Means for moving forward with comprehensive tax reform designed to spur growth of our nation's economy. Many of the provisions of the tax reform blueprint will be beneficial to farmers, including reduced income tax rates, reduced capital gains taxes, immediate expensing for all business inputs except land, and the elimination of the estate tax. The proposed loss of the deduction for business interest expense and the deduction for state and local taxes, however, is a cause for concern. The blueprint can be improved by guaranteeing the continuation of stepped-up basis, preserving cash accounting and maintaining like-kind exchanges.

The statement that follows focuses on and provides additional commentary on the tax reform issues most important to farmers and ranchers.

COMPRHENSIVE TAX REFORM WILL BOOST FARM AND RANCH BUSINESSES

Any tax reform proposal considered by Congress must be comprehensive and include individual as well as corporate reform and rate reduction. By far, the most common form of farm ownership is as a sole-proprietor. In total, farms and ranches operated as individuals, partners and

S corporation shareholders constitute about 97 percent of our nation's 2 million farms and ranches and about 85 percent of total agricultural production. Because many business deductions and credits are used by both corporate and pass-through businesses, their elimination without substantial rate reduction for all business entities could result in a tax increase for the vast majority of farmers and ranchers.

LOWER EFFECTIVE TAX RATES WILL BENEFIT FARM AND RANCH BUSINESSES

Farm Bureau supports reducing tax rates and views this as the most important goal of tax reform. While lower tax rates are important, the critical feature for farmers and ranchers is the effective tax rate paid by farm and ranch businesses. Tax reform that lowers rates by expanding the base should not increase the overall tax burden (combined income and self-employment taxes) of farm and ranch businesses. Because profit margins in farming and ranching are tight, farm and ranch businesses are more likely to fall into lower tax brackets. Tax reform plans that fail to factor in the impact of lost deductions for all business entities and for all rate brackets could result in a tax increase for agriculture.

Farming and ranching is a cyclical business. A period of prosperity can be followed by one or more years of low prices, poor yields or even a weather disaster. Without the opportunity to even out income over time, farmers and ranchers will pay more than comparable non-cyclical businesses. Tax code provisions like income averaging allow farmers and ranchers to pay taxes at an effective rate equivalent to a business with the same aggregate, but steady revenue stream. Farm savings accounts would accomplish the same objective plus allow a farmer or rancher to reserve income in a dedicated savings account for withdrawal during a poor financial year. Installment sales of land benefit both buyers and sellers by providing sellers with an even income flow and buyers with the ability to make payments over time.

ACCELERATED COST RECOVERY HELPS FARMERS REMAIN EFFICIENT

Farmers and ranchers need to be able to match income with expenses in order to manage their businesses through challenging financial times. Expensing allows farm and ranch businesses to recover the cost of business investments in the year a purchase is made. In addition to Sect. 179 small business expensing, the tax code also provides immediate cost recovery through bonus depreciation and through long-standing provisions that allow for the expensing of soil and water conservation expenditures, expensing of the costs of raising dairy and breeding cattle and for the cost of fertilizer and soil conditioners such as lime. Farm Bureau supports the expansion of immediate expensing.

Because production agriculture has high input costs, Farm Bureau places a high value on the immediate write-off of all equipment, production supplies and pre-productive costs. While Sect. 179 does provide full expensing for most small and mid-size farms, USDA reports that almost a quarter of the large farms that account for nearly half of all agricultural production made investments exceeding the expensing limit in 2015. Thus, an expansion of immediate expensing has the potential to change the investment behavior of farms responsible for a significant amount of agriculture production.

When farmers are not allowed immediate expensing they must capitalize purchases and deduct the expense over the life of the property. Accelerated deductions reduce taxes in the purchase year, providing readily available funds for upgrading equipment, to replace livestock, to buy production supplies for the next season and for farmers to expand their businesses. This is not only a benefit to production agriculture; a study in the journal Agricultural Finance Review found that for every $1,000 increase to the Section 179 expensing amount, farms that had been previously limited by the expensing amount made an incremental capital investment of between $320 and $1,110.

CASH ACCOUNTING HELPS FARM AND RANCH BUSINESSES TO CASH FLOW

Cash accounting is the preferred method of accounting for farmers and ranchers because it allows them to match income with expenses and aids in tax planning. Farm Bureau supports the continuation of cash accounting.

Cash accounting allows farmers and ranchers to improve cash flow by recognizing income when it is received and recording expenses when they are paid. This provides the flexibility farmers need to plan for major business investments and in many cases provides guaranteed availability of some agricultural inputs.

Under a progressive tax rate system, farmers and ranchers, whose incomes can fluctuate widely from year to year, will pay more total taxes over a period of time than taxpayers with more stable incomes. The flexibility of cash accounting also allows farmers to manage their tax burden on an annual basis by controlling the timing of revenue to balance against expenses and target an optimum level of income for tax purposes.

Loss of cash accounting would create a situation where a farmer or rancher might have to pay taxes on income before receiving payment for sold commodities. Not only would this create cash flow problems, but it also could necessitate a loan to cover ongoing expenses until payment is received. The use of cash accounting helps to mitigate this challenge by allowing farm business owners to make tax payments after they receive payment for their commodities.

DEDUCTING INTEREST EXPENSE IS IMPORTANT FOR FINANCING

Debt service is an ongoing and significant cost of doing business for farmers and ranchers who must rely on borrowed money to buy production inputs, vehicles and equipment, and land and buildings. Interest paid on these loans should be deductible because interest is a legitimate business expense. According to the USDA Economic Research Service, interest expense accounts for 17.9 percent of fixed expenses for farms and ranches. Immediate expensing will not offset the loss of this deduction, especially for the bulk of farmers and ranchers currently covered under Sect. 179 small business expensing.

Farm and ranch businesses are almost completely debt financed with little to no access to investment capital to finance the purchase of land and production supplies. In 2015, all but

5 percent of farm sector debt was held by banks, life insurance companies and government agencies. Without a deduction for interest, it would be harder to borrow money to purchase land and production inputs and the agriculture sector could stagnate.

Land has always been farmers' greatest asset, with real estate accounting for 79 percent of total farm assets in 2015. Since almost all land purchases require debt financing, the loss of the deduction for mortgage interest would make it more difficult to cash flow loan payments and could even make it impossible for some to secure financing at all. The need for debt financing is especially critical for new and beginning farmers who need to borrow funds to start their businesses.

REPEALING ESTATE TAXES WILL AID IN FARM TRANSISTIONS

Estate taxes disrupt the transition of farm and ranch businesses from one generation to the next. Farm Bureau supports estate tax repeal, opposes the collection of capital gains taxes at death and supports the continuation of unlimited stepped-up basis.

Farming and ranching is both a way of life and a way of making a living for the millions of individuals, family partnerships and family corporations that own more than 99 percent of our nation's more than 2 million farms and ranches. Many farms and ranches are multi-generation businesses, with some having been in the family since the founding of our nation.

Many farmers and ranchers have benefited greatly from congressional action that increased the estate tax exemption to $5 million indexed for inflation, provided portability between spouses, and continued the stepped-up basis. Instead of spending money on life insurance and estate planning, farmers are able to upgrade buildings and purchase equipment and livestock. And more importantly, they have been able to continue farming when a family member dies without having to sell land, livestock or equipment to pay the tax.

In spite of this much-appreciated relief, estate taxes are still a pressing problem for some agricultural producers. One reason is that the indexed estate tax exemption, now $5.49 million, is still catching up with recent increases in farmland values. While increases in cropland values have moderated over the last three years, cropland values remain high. On average cropland values are 62 percent higher than they were a decade ago. As a result, more farms and ranches now top the estate tax exemption. With 91 percent of farm and ranch assets illiquid, producers have few options when it comes to generating cash to pay the estate tax.

REDUCED TAXATION OF CAPITAL GAINS ENCOURAGES INVESTMENT

The impact of capital gains taxes on farming and ranching is significant. Production agriculture requires large investments in land and buildings that are held for long periods of time during which land values can more than triple. USDA survey data suggests about 40 percent of all family farms and ranches report some gain or loss, more than three times the average individual taxpayer. Farm Bureau supports reducing capital gains tax rates and wants an exclusion for farm land that remains in production.

Capital gains taxes are owed when farm or ranch land, buildings, breeding livestock and some timber are sold. While long-term capital gains are taxed at a lower rate than ordinary income to encourage investment and in recognition that long-term investments involve risk, the tax can still discourage property transfers or alternatively lead to a higher asking price.

Land and buildings typically account for 79 percent of farm or ranch assets. The current top capital gains tax is 20 percent. Because the capital gains tax applies to transfers, it provides an incentive to hold rather than sell land. This makes it harder for new farmers and producers who want to expand their business, say to include a child, to acquire property. It also reduces the flexibility farms and ranches need to adjust their business structures to maximize use of their capital.

STEPPED-UP BASIS REDUCES TAXES FOR THE NEXT GENERATION OF PRODUCERS

There is also interplay between estate taxes and capital gains taxes: stepped-up basis. Step-up sets the starting basis (value) of land and buildings at what the property is worth when it is inherited. Farm Bureau supports continuation of stepped-up basis.

Capital gains taxes on inherited assets are owed only when sold and only on gains over the stepped-up value. If capital gains taxes were imposed at death or if stepped-up basis were repealed, a new capital gains tax would be created and the implications of capital gains taxes as described above would be magnified. This is especially true for the vast majority of farmers and ranchers who are both under the estate tax exemption and have the benefit of stepped-up basis.

Stepped-up basis is also important to the financial management of farms and ranches that continue after the death of a family member. Not only are land and buildings eligible for stepped-up basis at death but so is equipment, livestock, stored grains, and stored feed. The new basis assigned to these assets resets depreciation schedules, providing farmers and ranchers with an expanded depreciation deduction.

LIKE-KIND EXCHANGES HELP AG PRODUCERS STAY COMPETITIVE

Like-kind exchanges help farmers and ranchers operate more efficient businesses by allowing them to defer taxes when they sell assets and purchase replacement property of a like-kind. Farm Bureau supports the continuation of Sect. 1031 like-kind exchanges.

Like-kind exchanges have existed since 1921 and are used by farmers and ranchers to exchange land and buildings, equipment, and breeding and production livestock. Without like-kind exchanges some farmers and ranchers would need to incur debt in order to continue their farm or ranch businesses or, worse yet, delay mandatory improvements to maintain the financial viability of their farm or ranch.

FARMERS AND RANCHERS PAY SIGNIFICANT STATE AND LOCAL TAXES

Farm Bureau supports continuation of the deduction for state and local taxes. Loss of the deduction for state and local taxes paid would have a significant impact on farm and ranch businesses. According to the USDA Economic Research Service, state and local property taxes account for 16 percent of fixed expenses for all farms. An additional, important contributing factor is that taxes are often built into the price of rent and lease payments, which are substantial for farms. Therefore, losing the state and local tax deduction likely would cause higher rent and lease payments. It should be noted that the figures for taxes mentioned above are only for real estate and property taxes and do not include any state income taxes if those exist. Therefore, the overall local and state tax burden is likely higher than stated above.

SUMMARY

Farm Bureau supports replacing the current federal income tax with a fair and equitable tax system that encourages success, savings, investment and entrepreneurship. We believe that the new code should be simple, transparent, revenue-neutral and fair to farmers and ranchers. Tax reform should embrace the following overarching principles:

- Comprehensive: Tax reform should help all farm and ranch businesses, including sole-proprietors, partnerships and sub-S and C corporations.
- Effective Tax Rate: Tax reform should reduce combined income and self-employment tax rates low enough to account for any deductions/credits lost due to base broadening.
- Cost Recovery: Tax reform should allow businesses to deduct expenses when incurred, including business interest expense. Cash accounting should continue. Sect. 1031 like-kind exchanges should continue. There should be a deduction for state and local taxes.
- Estate Taxes: Tax reform should repeal estate taxes. Stepped-up basis should continue.
- Capital Gains Taxes: Tax reform should lower taxes on capital investments. Capital gains taxes should not be levied on transfers at death.

THE AMERICAN INSTITUTE OF ARCHITECTS

STATEMENT FOR THE RECORD

The Honorable Peter Roskam, Chairman
The Honorable Lloyd Doggett, Ranking Member
U.S. House Committee on Ways and Means Subcommittee on Tax Policy

July 27, 2017

Introduction

Thank you for holding a hearing on July 13, 2017 entitled *How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs*. The American Institute of Architects ("AIA"), the leading professional membership association for architects since 1857, strongly supports comprehensive tax reform that lowers marginal tax rates for individuals, pass-through entities, and corporations, while broadening the tax base and simplifying the tax code.

We recognize that tax reform is a balancing act. Lowering tax rates will require curtailing or discarding many tax expenditures, while maintaining and improving a limited number of tax policies that support important policy objectives. But we see tax reform as an opportunity to provide taxpayers with much-needed certainty, simplicity, and fairness, while at the same time encouraging economic growth and job creation.

As such, we applaud you for your attention to this important matter. We are grateful for the opportunity to submit the following comments and to work with you to advance meaningful and lasting tax reform legislation.

Our strong hope is that tax reform results in simple, commonsense tax policies for businesses of all sizes, aimed to spur innovative, economically vibrant, sustainable, and resilient buildings and communities. As you pursue reform, we urge consideration of the following principles:

•Preserve tax policies that support and strengthen small businesses, which account for the vast majority of U.S. architecture firms;

•Advance tax policies that support economically vibrant, innovative, sustainable, and resilient buildings and communities; and

•Ensure fairness in the tax code.

This memorandum provides an overview of several policy initiatives to advance these principles that are of interest to the architecture profession. We appreciate your consideration of these initiatives as you move forward with the legislative process.

The American Institute of Architects
1735 New York Avenue, NW
Washington, DC 20006
www.aia.org

The American Institute of Architects

AIA represents more than 90,000 architects, emerging professionals and allied partners nationwide and around the world.

In 2015 alone, the 18,262 architecture firms owned by AIA members grossed billings of over $40 billion, driving economic activity and job growth in communities across America. Moreover, most architecture firms at which AIA members work are small businesses, with nearly 95 percent of firms having fewer than 50 employees.

Architects work to advance the public's quality of life through their commitment to healthy, safe, resilient and sustainable communities. From designing the next generation of energy-saving buildings to making our communities healthier and more vibrant and from helping neighborhoods rebuild after disasters, to exporting American design know-how to the rest of the world, architects turn dreams and aspirations into reality.

Strengthen Small Business

In the architectural profession, as in the broader economy, small businesses are an engine of economic growth and opportunity. As noted above, the overwhelming majority of U.S. architecture firms are small businesses with fewer than 50 employees. A significant portion of these firms are organized as pass-through entities, including partnerships and S corporations. Support for these small businesses should be a critical part of any tax reform effort.

Comprehensive, Not Piecemeal Reform

Tax reform can help small businesses expand their operations and drive job creation – but only if Congress takes a comprehensive approach to addressing tax issues for individuals, pass-through entities, and corporations. "Corporate-only" tax reform would leave pass-through entities at a severe disadvantage, harming architecture firms and other small businesses.

Reduced Tax Burdens for Pass-through Businesses

Architecture firms organized as pass-through businesses can face combined tax rates of 45 percent or more when federal, state and local taxes are accounted for – which amounts to one of the highest effective tax rates in the world. As such, we strongly support reductions in marginal tax rates for all business entities. Allowing businesses to keep more of their hard-earned money will encourage them to reinvest and hire more workers.

In addition, we appreciate your continued efforts to achieve greater parity between the corporate and pass-through tax systems through your work on "corporate integration." Rate parity is a key priority for the AIA, as it would eliminate distortions favoring certain forms of business entity over others. The tax code should not pick "winners" and "losers" in this way.

At the same time, we urge caution in establishing any requirement for sole proprietorships and pass-through businesses to pay or be treated as having paid "reasonable compensation" to their owners. We are concerned that such a requirement could inappropriately recategorize legitimate business income as compensation, leading to an effective tax increase on pass-through businesses. While the AIA recognizes the need to distinguish business income from compensation, this distinction must be drawn carefully to avoid penalizing the pass-through community.

Driving Investment in Energy Efficient Buildings

We are aware that several members of the Senate Finance Committee, as well as members of the House Ways and Means Committee, have an interest in expanded expensing of capital investment. Their interest reflects the strong link between cost recovery and economic growth. In the simplest terms, expensing puts more money back in the hands of business owners faster

– encouraging investment in new products and services.

Architects are familiar with the powerful positive effects of accelerated cost recovery through our experience with the Section 179D deduction for energy efficient commercial buildings. By allowing business owners to immediately expense the cost of energy efficient improvements, Section 179D has encouraged billions of dollars in capital investment and has supported hundreds of thousands of jobs in the construction, engineering, design, and manufacturing industries since it was added to the tax code in 2005.

These benefits are confirmed by a recent economic impact study conducted by Regional Economic Models, Inc. ("REMI"), the executive summary of which is attached to this statement as an appendix. REMI's conclusion is unequivocal, finding that "Section 179D is an engine of economic and employment growth." In particular, an enhanced tax incentive for energy efficient commercial buildings could support up to 76,529 jobs and contribute almost $7.4 billion toward our national GDP each year. These results represent a significant return on the taxpayer investment in Section 179D, well in excess of the provision's revenue cost.

Given this favorable analysis, we strongly believe that it is remains important to offer tax incentives for energy efficient design. The benefits of greater energy efficiency – cost savings, energy independence, and reduced carbon emissions, to name a few – are significant and demonstrate the impressive "return" on taxpayer investment in provisions like Section 179D.

Drive Taxpayer Savings through Energy Efficient Public Buildings

Section 179D's unique allocation provision has allowed tax-exempt public entities to allocate the deduction to the designer of a building or efficiency project. This feature enables architects and engineers, among others, to offer cost-effective design services for the development of energy efficient buildings by school districts, state governments, and other public sector entities. Allocation can help defray some of the upfront costs associated with energy efficient improvements, leading to significantly lower energy bills over the school's lifetime and, ultimately, more money in taxpayers' pockets.

The AIA encourages you and the Committee to ensure that the benefit of the allocation provision is retained as part of tax reform, notwithstanding any potential elimination of specific cost recovery provisions (such as Section 179D) in favor of expanded expensing more generally. Without the ability for tax-exempt entities to share the tax attributes associated with investments in energy efficient improvements with taxpayers that are able to use them, public entities will lose a crucial source of support for cost-effective energy efficient design. We would be pleased to share our ideas about possible ways to implement this important policy objective.

Improving International Competitiveness

American architects are leading the profession and industry around the world. Overseas demand for American architects is immense and growing as architecture firms engage with developing markets abroad. In this context, we strongly support proposals to enhance the international competitiveness of the U.S. tax code. For too long, our country's disproportionately high tax rates and complex "worldwide" method of taxation have curbed the potential for American businesses operating overseas. Eliminating these policies will make it easier for architecture firms and other American companies to compete abroad, driving growth here at home.

In addition, we note the House blueprint's discussion of the proposed elimination of the Section 199 deduction for domestic production activities. Section 199 includes specific provisions aimed to support domestic architectural services which have been instrumental in bolstering the competitiveness of American architects on the global stage. While we understand that reducing tax rates and shifting to full expensing may replicate some of the effects of the Section 199 deduction, we urge careful attention and analysis to ensure that the architecture firms and other American businesses that have benefited from this provision are not left "worse off" by its elimination in tax reform. American businesses continue to face extreme competitive pressures in the global marketplace, and the tax system should not impose any competitive disadvantages on U.S. firms.

Supporting a Vibrant Built Environment

The tax code can be a powerful tool to support innovative, economically vibrant, sustainable, and resilient buildings and communities. To that end, we encourage you and the Committee to continue and improve tax policies aimed at historic preservation and innovation.

Preserve Incentives for Historic Preservation

Among the most important incentives supporting revitalization of communities throughout the country is the Section 47 Historic Rehabilitation Tax Credit ("HTC"). Weakening or eliminating this credit would endanger the economic feasibility of nearly all historic rehabilitation projects. Without the HTC, the numbers simply do not work. The rehabilitation of historic building suffers from a financing gap because rehabilitation is more expensive than new construction. Also, 84 percent of all HTC transactions are located in low-income census tracts. Without tax incentive support, these properties could sit vacant for decades, exerting a blighting influence on the surrounding neighborhood.

Research conducted for the National Park Service by the Rutgers Center for Urban Policy Research documents that since enactment of the HTC in 1981, the credit has leveraged $117 billion in private investment in historic rehabilitation, created nearly 2.5 million jobs and supported the rehabilitation of more than 40,000 historic buildings. The HTC is the most significant federal investment in historic preservation. It has also proven to be an efficient use of taxpayer dollars. Over the credit's 34 year history, the federal government has allocated just over $24 billion in tax credits, but collected $28.6 billion in federal tax revenue from rehabilitation projects – more than paying for the program. For every dollar of public expenditure, private investors contribute four dollars toward the rehabilitation of historic properties.

Rehabilitation projects across the country are putting Americans back to work. In a typical project, 60-70 percent of the total cost is labor as compared to new construction where labor often accounts for less than 50 percent of the total cost. Laborers on a rehabilitation project are more likely to be hired locally, so their earnings support the local economy. In fact, 75 percent of the total economic impact of a historic rehabilitation project accrues to the state and city where the property is located. Moreover, projects are ideally suited to completion by emerging small businesses.

Given the HTC's proven track record of driving economic and employment growth across the country, we strongly urge you and the Committee to retain this important incentive in tax reform.

Enhance Incentives for Innovation

Architecture is not merely an exercise in aesthetics. As buildings become more complex and clients demand more from their designs, architects must innovate to develop new ways to redefine what is possible. This often requires complex modeling and advanced computational analysis to assess everything from soil composition to wind resistance, supported by bespoke software and other tools. The Section 41 credit for research and development activities ("R&D Credit") provides a critical incentive for firms to pursue these innovations.

However, while a number of activities associated with architectural design qualify for the R&D Credit, over the years AIA members have reported a variety of complications in claiming the incentive, leading to costly and time-consuming audits. Improving the R&D Credit's administrability for design-related innovations should be an area of focus in tax reform. Making it easier for design firms to claim the credit will help drive new advances in design, and enhance architects' efforts to transform the built environment.

Preserve the Cash Method of Accounting

Architecture firms and other professional service companies rely on the cash method of accounting to track their income and expenses. The cash method is rooted in a simple principle: businesses – particularly small businesses that may lack sophisticated bookkeeping capabilities – should pay taxes on income when payment is received.

Unfortunately, some have proposed repealing or limiting the availability of the cash method, requiring businesses to shift to the more complex accrual method. Under the accrual method, firms pay taxes when the right to receive income is fixed – not when they actually receive payment. As a result, requiring these firms to use the accrual method would subject those who own and operate these businesses to immediate taxation on uncollected revenues. This would have severe and significant negative consequences on these businesses and their owners:

•It would result in an effective tax increase to the owners because they will be taxed on income that they have not received, without a concomitant increase in expenses.

•It will lead to significant cash-flow problems. For example, among professional services firms the primary cost is labor, and businesses must regularly pay their employees even if they are not paid by their clients for several months. The use of cash accounting helps to mitigate this challenge by matching the timing of tax liabilities with the collection of the income being taxed.

•Cash accounting is clear and straightforward, while accrual accounting adds complexity and opacity, increasing the burdens faced by these businesses and their owners and forcing them to commit even more scarce resources to compliance efforts.

•It will impair business growth and job creation by tying up funds otherwise available for expansion.

The cash to accrual proposal undermines the core principles of tax reform: facilitating growth, creating jobs, making U.S. businesses more competitive, providing certainty and making the tax code more fair and simple. In fact, this proposal would burden relatively small businesses with complex changes in accounting practices, immediate tax increases, and unequal footing with similarly situated businesses that receive payment at the time of delivery of goods or services. We strongly urge you and the Committee to preserve the full availability of the cash method in tax reform.

Conclusion

As you move forward with tax reform, we urge support for the policy goals described above: strengthening small businesses; supporting innovative, smart, energy-efficient, and resilient development; and promoting fairness in the tax code. Tax reform following these principles would provide taxpayers with much-needed certainty, simplicity, and fairness, while at the same time encouraging economic growth and job creation.

The AIA and its members are ready to serve as a resource to you and the Committee on these and other issues. Thank you for your consideration of our comments and your leadership on these important issues.

Analysis of Proposals to Enhance and Extend the Section 179D Energy Efficient Commercial Buildings Tax Deduction

Prepared by Regional Economic Models, Inc. (REMI) May 2017

Executive Summary

Section 179D of the Internal Revenue Code, the Energy Efficient Commercial Buildings Deduction, was originally enacted by Congress as part of the Energy Policy Act of 2005 to promote energy independence. Section 179D promotes the proper allocation of incentives in the real estate development process. A key challenge to realizing the benefits of energy-efficient improvements is that the associated cost savings flow to building occupants, not developers. By helping offset the cost of energy efficient investments, Section 179D allows building owners to share in the incentive to install energy-efficient improvements that help their occupants save money on electricity, water, and climate control costs. In so doing, Section 179D promotes private-sector solutions to improve conservation practices and modernize national infrastructure.

In this analysis, REMI evaluates the economic impact of three potential approaches to the Section 179D deduction, which most recently expired at the end of 2016:

1. **Strengthening and Modernizing Section 179D**,[1] which would increase the value of the deduction to $3.00 per square foot from $1.80, increase the applicable energy efficiency standards, make it available to support improvements to existing as well as new buildings, and extend the deduction.
2. **Extension of Current Law Section 179D plus Expansion to Non-Profits and Tribal Governments**,[2] modeled on 2015 legislation developed by the Senate Finance Committee under Chairman Orrin Hatch (R-UT), which would extend the deduction, expand availability of the deduction to nonprofit organizations and tribal governments and increase the applicable energy efficiency standards.
3. **Extension of Current Law Section 179D**,[3] modeled on the two-year extension of current law enacted as part of the Protecting Americans from Tax Hikes ("PATH") Act of 2015.

The results of this analysis show that in addition to advancing the goal of energy independence, **Section 179D is an engine of economic and employment growth**. As captured in the table below, this study quantifies these impacts, finding that:

- Strengthening and extending the Section 179D Energy-Efficiency Commercial Buildings Deduction will create jobs and expand the nation's economy. These benefits would be compounded by increasing the dollar value of the deduction in accordance with several Congressional and administration proposals.

- These enhancements to Section 179D would support up to 76,529 jobs annually and contribute annually almost $7.4 billion to national gross domestic product ("GDP"), as well as over $5.7 billion towards national personal income.

- Expanding the availability of the deduction to nonprofit organizations and tribal governments, while increasing the applicable energy efficiency standards, also provide clear positive impacts to the economy.

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[1] Proposals along these lines include Title I of S. 2189, sponsored by Senator Cardin (D-MD) in the 113th Congress and the President's FY 2017 Budget Proposal. *See* Description of Certain Revenue Provisions Contained in the President's Fiscal Year 2017 Budget Proposal, Joint Committee on Taxation, July 2016, JCS-2-16.

[2] *See* Description of the Chairman's Mark of a Bill to Extend Certain Expired Tax Provisions, July 17, 2015, JCX-101-15, and Description of the Chairman's Modification to the Chairman's Mark of a Bill to Extend Certain Expired Tax Provisions, July 21, 2015, JCX-103-15. In addition to the Senate Finance Committee extenders bill, other proposals

Table 1. Average Annual Economic Impacts for First Ten Years

	Strengthen and Modernize	Extension plus Expansion	Extension of Current Law
Jobs	76,529	39,388	40,749
GDP (millions of dollars)	7,398	3,730	3,860
Personal Income (millions of dollars)	5,729	3,017	3,128

AICPA

WRITTEN STATEMENT

OF

THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

SUBMITTED FOR THE RECORD OF THE

JULY 13, 2017

HEARING OF

THE UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TAX POLICY

ON

HOW TAX REFORM WILL HELP AMERICA'S SMALL BUSINESSES GROW AND CREATE NEW JOBS

1455 Pennsylvania Ave. NW, Washington, DC 20004-1081
T: +1 202.737.6600 F: +1 202.638.4512
aicpaglobal.com | cimaglobal.com | aicpa.org | cgma.org

INTRODUCTION

The American Institute of CPAs (AICPA) applauds the leadership taken by the Subcommittee to consider ways to reduce the burden and complexity of tax compliance faced by small businesses to ensure that tax rules support rather than discourage growth of businesses, particularly small businesses. Small businesses are the backbone of the United States (U.S.) economy, accounting for 54% of all U.S. sales and providing 55% of all jobs.[1]

Unfortunately, federal tax laws hinder growth for both small businesses and the U.S. economy. The increased time and effort needed to comply with the ever-changing tax laws forces small businesses to devote extra time and dollars to tax compliance instead of growing their businesses. Time spent learning and complying with current tax laws often does not save time in future years as rules may change. According to a National Taxpayers Union Foundation study, the U.S. economy loses $233.8 billion annually from dedicating 6.1 billion hours complying with tax laws.[2]

Nonetheless, we recognize that tax compliance is necessary. In the interest of good tax policy and effective tax administration to help small businesses grow, we offer suggestions where Congress and the Internal Revenue Service (IRS or "Service") can help reduce the compliance burden, increase transparency and provide certainty.

GOOD TAX POLICY

First, we should consider the features of an ideal tax system for small businesses. The AICPA urges the Committee to consider comprehensive tax reform that focuses on simplification and other *Principles of Good Tax Policy*[3] as explained in a report we recently updated and issued.[4] Our tax system must be administrable, support economic growth, have minimal compliance costs, and allow taxpayers to understand their tax obligations.

We believe these features are achievable if the following twelve principles of good tax policy are considered in the design of the system:

- Equity and Fairness
- Convenience of Payment
- Information Security
- Neutrality
- Certainty
- Effective Tax Administration
- Simplicity
- Economic Growth and Efficiency

[1] U.S. Small Business Administration, Small Business Trends, "Small Business, Big Impact!"
[2] National Taxpayers Union Foundation, Study: $233.8 Billion, 6.1 Billion Hours Lost to Rising Tax Complexity, April 8, 2015. Also see IRS National Taxpayer Advocate Annual Report to Congress, IR-2013-3 (1/9/13).
[3] AICPA concept statement, "Tax Policy Concept Statement 1, Guiding Principles for Good Tax Policy: A Framework for Evaluating Tax Proposals," January 2017.
[4] For an explanation of why and how the AICPA Principles of Good Tax Policy were updated, see "Tax Principles for the Digital Age," May 1, 2017.

- Transparency and Visibility
- Accountability to Taxpayers
- Minimum Tax Gap
- Appropriate Government Revenues

Our profession has long-advocated for a transparent tax system. For example, we urge Congress to use a consistent definition of taxable income without the use of phase-outs. Provisions, such as phase-out rules, that limit or eliminate the use of certain deductions and exclusions for those taxpayers in higher tax brackets, perpetuate the flaws of the current system, leading to nontransparent tax results and increased complexity. These rules also create marginal rates in excess of the statutory tax rate. In addition, multiple tax regimes (such as, the alternative minimum tax (AMT), which applies in addition to the regular income tax) make it almost impossible for taxpayers, including small business owners, to easily know their effective and marginal tax rates. Multiple tax regimes also make it difficult for owners to develop effective businesses plans. We urge Congress to use tax reform as an opportunity to remove phase-outs and multiple tax regimes, and develop the best definition of taxable income or adjusted gross income by creating simple, transparent, tax rules applied consistently across all rate brackets, eliminating additional complex and hidden taxes.

We also urge you to make tax provisions permanent. For all businesses, and small businesses in particular, uncertainty in the Internal Revenue Code (IRC or "Tax Code") creates unnecessary confusion and anxiety. Complexity can also result in taxpayers not taking full advantage of provisions intended to help them, resulting in higher taxes and greater compliance costs. While our Tax Code has always had a tendency to change, in recent years the rate of change has accelerated. Statutory changes result in new regulations, revenue procedures, notices and new or modified tax forms which take time and resources to understand and address. America's entrepreneurs need a Tax Code that is simple, transparent, and certain.

AICPA PROPOSALS

1. Cash Method of Accounting

The AICPA supports the expansion of the number of taxpayers who may use the cash method of accounting.[5] The cash method of accounting is simpler in application than the accrual method, has fewer compliance costs, and does not require taxpayers to pay tax before receiving the related income. Therefore, entrepreneurs often choose this method for small businesses.

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 partnerships and S corporations. Requiring businesses to switch to

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[5] AICPA letter, "Investment in New Ventures and Economic Success Today Act of 2017 (S. 1144)," June 22, 2017.

the accrual method upon reaching a gross receipts threshold unnecessarily creates a barrier to growth.[6]

The AICPA believes that limiting the use of the cash method of accounting for service businesses would:

- Discourage natural small business growth;
- Impose an undue financial burden on their individual owners;
- Increase the likelihood of borrowing;
- Impose complexities and increase their compliance burden; and
- Treat similarly situated taxpayers differently (because income is taxed directly on their owners' individual returns).

Congress should not further restrict the use of the long-standing cash method of accounting for the millions of the U.S. businesses (e.g., sole proprietors, personal service corporations, and pass-through entities) currently utilizing this method.

2. Tax Rates for Pass-through Entities

If Congress, through tax reform, lowers the income tax rates for C corporations, all business entity types should receive a rate reduction. The majority of businesses are structured as pass-through entities (such as, partnerships, S corporations, or limited liability companies).[7] Tax reform should not disadvantage these entities or require businesses to engage in complex entity changes to obtain favored tax status.

Congress should continue to encourage, or more accurately – not discourage, the formation of sole proprietorships and pass-through entities as these business structures provide the flexibility and control desired by many business owners that is not available within the more formal corporate structure. Entrepreneurs generally do not want to create entities that require extra legal obligations (such as holding annual meetings of a board of directors). They prefer business structures that are simple and provide legal and tax advantages.

3. Distinguishing Compensation Income

If Congress provides a reduced rate for active business income of sole proprietorships and pass-through entities, we recognize that it will place additional pressure on the distinction between the profits of the business and the compensation of owner-operators. We recommend determining compensation income by using traditional definitions of "reasonable

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[6] A required switch to the accrual method affects many small businesses in certain industries including accounting firms, law firms, medical and dental offices, engineering firms, and farming and ranching businesses.
[7] See Census Bureau, County Business Patterns; Census Bureau, Nonemployer Statistics.

compensation" supplemented, if necessary, by additional guidance from the United States Department of the Treasury ("Treasury").

We encourage Congress to consider codifying the existing judicial guidance on the definition of reasonable compensation that reflects the type of business (for example, labor versus capital intensive), the time spent by owners in operating the business, owner expertise and experience, and the existence of income-generating assets in the business (such as other employees and owners, capital and intangibles).

We acknowledge that reasonable compensation has been the subject of controversy and litigation (hence, the numerous court decisions helping to define it). Therefore, Congress should direct the IRS to take additional steps to improve compliance and administration in this area. For example, a worksheet maintained with the taxpayer's tax records would allow businesses to indicate the factors considered in determining compensation in a reasonable and consistent manner.

These potential factors include:

- Approximate average hours per week worked by all owners;
- Approximate average hours worked per week by non-owner employees;
- The owner's years of experience;
- Guidance used to help determine reasonable compensation for the geographic area and years of experience (e.g., wage data guides provided by the U.S. Bureau of Labor Statistics); and
- Book value and estimated fair market value of assets that generate income for the business.

Changes to payroll tax rules, such as a requirement for partnerships and proprietorships to charge reasonable compensation for owners' services and to withhold and pay the related income and other taxes, will also facilitate compliance for small businesses. We suggest that partners and proprietors are not treated as "employees," but rather owners subject to withholding – a new category of taxpayer – similar to a partner with a guaranteed payment for services but on which income tax withholding is required. Similar rules requiring reasonable compensation currently exist in connection with S corporations and such owners are considered employees of the S corporation. The broader inclusion of partners and proprietors in more well-defined compensation rules should facilitate and enhance the development of appropriate regulations and enforcement in this area.

There are advantages to using a reasonable compensation approach for owners of all business types, including:

- Fairness that respects the differences among business types and owner participation levels;
- A reduced reliance by taxpayers and the IRS on quarterly estimated tax payments for timely matching of the earning process and tax collection;
- Diminished reliance on the self-employment tax system (since businesses would include payroll taxes withheld from owners and paid for owners along with their employees); and
- Simplification due to uniformity of collection of employment tax from business entities, and an ability to rely on a deep foundation of case law (in the S corporation and personal service corporation areas) to provide regulatory and judicial guidance.

In former Ways & Means Committee Chairman Dave Camp's 2014 discussion draft,[8] a proposal was included to treat 70% of pass-through income of an owner-operator as employment income. While this proposal presents a simple method, it would result in an inequitable result in many situations. If Congress moves forward with a 70/30 rule, or other percentage split, we recommend making the proposal a safe harbor option. For example, the proposal must make clear that the existence and the amount of the safe harbor is not a maximum amount permitted but that the reasonable compensation standard utilized for corporations will remain available to sole proprietorships and pass-through entities. These rules will provide a uniform treatment among closely-held business entity types. Appropriate recordkeeping, when the safe harbor option is not used, would also address the enforcement challenges currently faced by the IRS.

4. Limitation on Interest Expense Deduction

Another important issue for small businesses is the ability to deduct their interest expense. New business owners incur interest on small business loans to fund operations prior to revenue generation, working capital needs, equipment acquisition and expansion, and even to build credit for larger future loans. These businesses rely on financing to survive. Equity financing for many start-up businesses is simply not available. A limitation in the deduction for interest expense (such as to the extent of interest income) would effectively eliminate the benefit of a valid business expense for many small businesses, as well as many professional service firms. If a limit on the interest expense deduction is paired with a proposal to allow for an immediate write-off of acquired depreciable property, it is important to recognize that this combination adversely affects service providers and small businesses while offering larger manufacturers, retailers, and other asset-intensive businesses a greater tax benefit.

Currently, small businesses can expense up to $510,000 of acquisitions per year under section 179 and deduct all associated interest expense. One tax reform proposal[9] under consideration

[8] H.R. 1 (113th Congress), The Tax Reform Act of 2014, Sec. 1502; also see Section-by-Section Summary, pages 32-33.
[9] House Republican's Tax Reform Task Force Blueprint, "A Better Way: Our Vision for a Confident America," June 24, 2016.

would eliminate the benefit of interest expense while allowing immediate expensing of the full cost of new equipment in the first year. However, since small businesses do not usually purchase large amounts of new assets, this proposal would generally not provide any new benefit for smaller businesses (relative to what is currently available via the section 179 expensing rule). Instead, it only takes away an important deduction for many small businesses who are forced to rely on debt financing to cover their operating and expansion costs.

5. Definition of "Compensation"

Tax reform discussions have considered whether the tax system should use the same definition for taxable compensation of employees as it does for the compensation that employers may deduct. Businesses may lose some of their current payroll-type deductions if employees are not required to report those same compensation amounts as income.

We are concerned, particularly from a small business perspective, about any decrease of an employer's ability to deduct compensation paid to employees, whether in the form of wages or fringe benefits (health and life insurance, disability benefits, deferred compensation, etc.). We are similarly concerned about expansion of the definition of taxable income for the employees, or removal of the exclusion for fringe benefits. Such changes in the Tax Code would substantially impact the small and labor-intensive businesses' ability to build and retain a competitive workforce.

6. Net Operating Losses

We recommend that Congress provide tax relief to small businesses in the calculation of benefits related to net operating losses (NOLs). An NOL is generally the amount by which a taxpayer's business deductions exceed its gross income. Corporations currently operating at a loss can benefit from carrying these NOLs back or forward to offset taxable income. According to the current rules, these losses are not deducted in the year generated, but are carried back two years and carried forward 20 years to offset taxable income in such years.

One of the purposes of the NOL carryback and carryover rules is to allow a taxpayer to better reflect its economic position over a longer period of time than generally is allowed under the restraint of the annual reporting period. Since 1987, our experience with the 90% AMT limitation on the use of NOLs shows that this limitation often imposes a tax on corporations, especially small businesses in their early growth years, when such businesses are still struggling economically. Therefore, a proposal[10] for a 90% limitation on NOLs imposes an artificial restriction on a company's use of business losses and discriminate against companies with volatile income. The limitation could result in loss companies paying more tax than companies with an equal amount of steady income over the same period.

[10] *Id.*

We also recommend that Congress simplify the calculation while retaining the carryback option for small businesses. For sole proprietors, the calculation of the NOL is overly complicated. Most startup businesses are formed as pass-through entities[11] and the initial startup losses incurred are "passed down" and reported on the owners' tax returns. Since individual taxpayers' report both business and nonbusiness income and deductions on their returns, the required calculations to separate allowed business losses from disallowed personal activities is complex.[12] Individual business owners would benefit from more specific guidance on NOL computations that is simple to understand and calculate.

7. Increase of Startup Expenditures

In the interest of economic growth, we encourage Congress to consider increasing the expensing amount for startup expenditures. Section 195 allows immediate expensing of up to $5,000 of startup expenditures in the tax year in which the active trade or business begins. This amount is reduced dollar for dollar once total startup expenditures exceed $50,000, with the excess amortized ratably over 15 years. Thus, once startup expenditures exceed $55,000, all of the startup expenditures are amortized over 15 years. The rationale for the $5,000 expensing was to "help encourage the formation of new businesses that do not require significant startup or organizational costs."[13] These dollar amounts, which were added in 2004, are not adjusted for inflation. Only for tax years beginning in 2010, the expense limit of $5,000 was increased to $10,000 and the $50,000 phase-out level was increased to $60,000.[14]

The AICPA recommends increasing the $5,000 expense limit and $50,000 phase out amounts of section 195 and adjusting them annually for inflation. These changes will further simplify tax compliance for small businesses by reducing (or eliminating) the number of businesses that must track and report amortization of startup expenses over a 15-year period. In addition, as was suggested for the 2004 and 2010 legislative changes, the larger dollar amounts will better encourage entrepreneurship. Higher dollar amounts also reflect the costs for legal, accounting, investigatory, and travel that are frequently incurred when starting a new business. Also, in light of the increased, inflation-adjusted dollar amounts under section 179[15] to help small businesses, it is appropriate to similarly increase the section 195 dollar amounts and adjust them annually for inflation.

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[11] Center for American Progress, "Ending the Pass-Through Tax Loophole for Big Business," August 2016.
[12] IRS Publication 536.
[13] P.L. 108-357 (10/22/04), American Jobs Creation Act, Sec. 902; Joint Committee on Taxation, General Explanation of Tax Legislation Enacted In the 108th Congress, JCS-5-05, p. 504, May 31, 2005.
[14] P.L. 111-240 (9/27/10), the Small Business Jobs Act of 2010, Sec. 2031(a); Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 111th Congress, JCS-2-11, p. 474, March 2011.
[15] P.L. 114-113 (12/18/15), Sec. 124(a).

8. Mobile Workforce

The AICPA supports the Mobile Workforce State Income Tax Simplification Act of 2017, H.R. 1393, which provides a uniform national standard for non-resident state income tax withholding and a *de minimis* exemption from the multi-state assessment of state non-resident income tax.[16]

The current situation of having to withhold and file many state nonresident tax returns for just a few days of work in various states is too complicated for both small businesses and their employees. Businesses, including small businesses and family businesses that operate interstate, are subject to a multitude of burdensome, unnecessary and often bewildering non-resident state income tax withholding rules. These businesses struggle to understand and keep up with the variations from state to state. The issue of employer tracking and complying with all the different state and local tax laws is quite complicated, consumes a lot of time and is costly.

H.R. 1393 would provide long-overdue relief from the current web of inconsistent state income tax and withholding rules on nonresident employees. Therefore, we appreciate the House of Representatives passing H.R. 1393 that provides national uniform rules and a reasonable 30 day *de minimis* threshold before income tax withholding is required.

9. Retirement Plans

Small businesses are burdened by the overwhelming number of rules inherent in adopting and operating a qualified retirement plan. Currently, there are four employee contributory deferral plans: 401(k), 403(b), 457(b), and SIMPLE plans. Having four variations of the same plan type causes confusion for many plan participants and small businesses. A suggested approach is to eliminate SIMPLE IRAs and amend the rules of SEPs to allow for salary reduction contributions, as previously permitted. In addition, Congress could eliminate the SIMPLE 401(k) plan because while the fees are similar to that of a 401(k) plan, the 401(k) is favored since it is more flexible.

We also propose eliminating the top-heavy rules because they constrain the adoption of 401(k) plans 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 made the need for separate top-heavy rules unnecessary. The existing discrimination rules for retirement plans ensure that non-highly compensated employees receive nondiscriminatory benefits such that the top-heavy rules often do not increase benefits in a meaningful way. In addition, the annual contribution limitations ensure that no employee's benefits are excessive.

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[16] For additional details, see AICPA written statement, "AICPA Statement for the Record of the April 13, 2016 Hearing on "Keep it Simple: Small Business Tax Simplification and Reform, Main Street Speaks," April 7, 2016.

10. Tax Administration

As we approach the 20th anniversary of the Report of the National Commission on Restructuring the IRS ("Restructuring Commission"), we recommend that any effort to modernize the IRS and its technology infrastructure should build on the foundation established by the Restructuring Commission. The current degradation of the IRS taxpayer services is unacceptable. The percentage of calls from taxpayers the IRS answered between 2004 and 2016 has dropped from 87% to 53%, however, the need for taxpayer assistance increased (the number of calls the IRS received increased from 71 million to 104 million).[17]

As tax professionals, we represent one of the IRS's most significant stakeholder groups.[18] As such, we are both poised and committed to being part of the solution for improving IRS taxpayer services. We recently submitted a letter[19] to House Ways and Means Committee and Senate Finance Committee members in collaboration with other professional organizations. Our recommendations include modernizing IRS business practices and technology, re-establishing the annual joint hearing review, and enabling the IRS to utilize the full range of available authorities to hire and compensate qualified and experienced professionals from the private sector to meet its mission. The legislative and executive branches should work together to determine the appropriate level of service and compliance they want the IRS accountable for and then dedicate appropriate resources for the Service to meet those goals.

Additionally, we recommend the IRS create a new dedicated practitioner services unit to rationalize, enhance, and centrally manage the many current, disparate practitioner-impacting programs, processes, and tools. Enhancing the relationship between the IRS and practitioners would benefit both the IRS and the millions of taxpayers, including small businesses, served by the practitioner community. As part of this new unit, the IRS should provide practitioners with an online tax professional account with access to all of their clients' information. The IRS should offer robust practitioner priority hotlines with higher-skilled employees that have the experience and training to address complex issues. Furthermore, the IRS should assign customer service representatives (a single point of contact) to geographic areas in order to address challenging issues that practitioners could not resolve through a priority hotline.

11. Emerging Issues

Online crowdfunding and the sharing economy are quickly expanding mediums through which individuals obtain funds, seek new sources of income, and start and grow businesses. Individuals may understand the steps through which they can use these new crowdfunding and

[17] National Taxpayer Advocate, *Annual Report to Congress 2016, Executive Summary: Preface, Special Focus and Highlights*, page 16, 2016.
[18] 60% of all e-filed returns in 2016 were prepared by a tax professional, according to the Filing Season Statistic for Week Ending Dec. 2, 2016.
[19] AICPA letter, "Ensuring a Modern-Functioning IRS for the 21st Century," April 3, 2017.

sharing economy opportunities to their advantage. However, many small businesses do not have the guidance necessary to accurately comply with the complex, out-of-date, or incomplete tax rules in these emerging areas.

Lawmakers and tax administrators must regularly review existing laws, against new changes in the ways of living and doing business, to determine whether tax rules and administration procedures need modification and modernization. We urge Congress and the IRS to develop simplified tax rules and related guidance in the emerging sharing economy and crowdfunding areas.[20] Some of the areas in need of modernization include information reporting (such as to avoid reporting excluded income, such as a gift as income), simplicity in reporting and tracking rental losses from year to year, and simplified approaches for recordkeeping for small businesses. Offering clarity on these issues will allow taxpayers to follow a fair and transparent set of guidelines while the IRS benefits from a more efficient voluntary tax system.

CONCLUDING REMARKS

Tax compliance requirements have become an everyday burden for small businesses. The current complexity and uncertainty of the Tax Code forces small businesses to utilize critical resources and can hinder their ability to grow and create jobs. As Congress tackles the complex issues inherent in drafting tax legislation, we encourage you to consider tax reform that will provide simplicity, certainty and clarity for small business owners.

The AICPA has consistently supported tax reform simplification efforts because we are convinced such actions will reduce small businesses' compliance costs and fuel economic growth. The AICPA appreciates the opportunity to submit this written testimony and we look forward to working with the Subcommittee as you continue to address the needs of small businesses.

The AICPA is the world's largest member association representing the accounting profession with more than 418,000 members in 143 countries and a history of serving the public interest since 1887. Our members advise clients on federal, state, local 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 businesses, as well as America's largest businesses.

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[20] AICPA written statement, "The 2017 Filing Season: IRS Operations and the Taxpayer Experience," April 6, 2017.

American Sustainable Business Council

July 26, 2017

The Honorable Kevin Brady
Chairman
Ways and Means Committee
1102 Longworth HOB
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
Ways and Means Committee
1102 Longworth HOB
Washington, D.C. 20515

RE: Tax Reform and Small Businesses hearing on July 13, 2017

Dear Chairman Brady and Ranking Member Neal:

The American Sustainable Business Council (ASBC) applauds the effort of the Ways & Means Committee to advance the growth of small businesses and the jobs they create. ASBC believes that tax reform must provide equitable tax incentives for the growth of small and midsize businesses.

ASBC has long advocated for changes at the federal and state levels that support a more sustainable economy, including taxation that rewards risk-taking entrepreneurs, creates and maintains quality jobs, encourages worker ownership, and reduces compliance costs.

While we applaud the committee's efforts to advance the growth of small business, we believe that some of Rep. Ryan's proposals would fail to achieve the stated objectives. Like President Trump, Rep. Ryan would unnecessarily cut taxes for the wealthy, by repealing the estate tax, which affects less than one-percent of American estates. Moreover, its repeal would cost $269 billion over 10 years, according to the Joint Committee on Taxation.

Tax cuts for the wealthy do little to benefit small businesses and boost the economy, because wealthy people spend a small percentage of their income on the consumption that drives the economy. By contrast, cutting taxes for ordinary Americans (who spend a lot on consumption) will boost the economy.

Rep. Ryan and the President also propose tax cuts for U.S. multinationals, arguing that U.S. taxes are too high for our largest companies to compete overseas. Yet if you look at our

TEL: 202.595.9302
1001 G STREET NW, SUITE 400E
WASHINGTON DC 20001-4559
ASBCOUNCIL.ORG

multinationals' effective tax rates – reflecting how much they actually pay – they're much lower than their U.S. statutory tax rates.

To support small businesses, ASBC believes that tax reform should:

- Direct investment to businesses, buildings, and equipment to create new jobs;
- Reduce tax preferences for established industries which don't need the support;
- Encourage domestic investment and job creation, as much as international treaties permit;
- Create a sustainable revenue source, such as a user-fee, to finance infrastructure work;
- Set an Impact Fee on carbon fuels to encourage environmentally sustainable practices;
- Limit the immediate write-off to equipment and not buildings (or at most manufacturing);
- Instead of repealing the Alternative Minimum Tax, raise its exemption amounts;
- Make health insurance exclusions equally available to all forms of business; and
- Set a low maximum tax rate for small business operating income.

We also encourage the Committee to support one of the most powerful ideas for creating a more robust economy -- worker ownership.

Over the next decade, tens of thousands of businesses will be sold or shut down as their baby-boomer owners retire. By one estimate, up to 20,000 of these businesses must be sold each year. Without buyers, they may be shuttered, downsized, or relocated. These businesses don't have to close. Many can be sold to the people they employ. By acting to support the worker ownership of businesses, Congress can help to solve this business succession crisis.

Congress can take several actions to support worker ownership, including the use of tax reform to create tax parity for all forms of worker-owned companies, whether these are worker cooperatives or Employee Stock Ownership Plans (ESOPs), which can be created by either C Corps or S Corps. While there is no bill that does this for both worker coops and ESOPs, there is an ESOP bill (The Promotion and Expansion of Private Employee Ownership Act of 2017, H.R. 2092) which gives S Corp owners the same tax deferral that C Corp owners now get on their ESOP stock sales to workers. ASBC supports this bill, but believes that it should also give worker coops the same or similar tax benefits.

Worker-owned companies have a track record of increasing wages, strengthening local economies, and saving companies that might close otherwise. Moreover, they're resilient. During the Great Recession, many had fewer layoffs, higher survival rates, and faster recoveries than traditional businesses

ASBC overview

Founded in 2009, ASBC is a growing coalition of businesses and business networks committed to advancing policies that support a vibrant, equitable, and sustainable economy. The Council brings together the perspective, experience, and political will of businesses to stimulate our economy, strengthen our communities, and preserve our environment. Today, the organizations that have joined in this partnership represent over 250,000 businesses.

Sincerely,

Richard Eidlin

Vice President & Co-Founder

Link to ASBC's business members

http://asbcouncil.org/membership/member-businesses#.WW-SrXg_OqA

Link to ASBC's association members

http://asbcouncil.org/membership/member-organizations#.WW-TJng_OqA

TEL: 202.595.9302
1001 G STREET NW, SUITE 400E
WASHINGTON DC 20001-4559
ASBCOUNCIL.ORG

Written testimony of the

Biotechnology Innovation Organization

Submitted to the United States House of Representatives Committee on Ways and Means, Subcommittee on Tax Policy

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How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs

July 13, 2017

Chairman Roskam, Ranking Member Doggett, and Members of the Subcommittee, the Biotechnology Innovation Organization (BIO) applauds you for convening this hearing and for your dedication to reforming America's corporate tax code to make it competitive on the global stage. We also strongly support your efforts to ensure that tax reform bolsters America's small businesses, enabling them to hire more workers and drive the U.S. economy into the 21st century.

BIO represents more than 1,100 innovative biotechnology companies, the vast majority of which are small businesses. A typical biotech has fewer than 50 employees (most of whom are scientists) and is dedicating vast sums of investment capital to the decades-long, billion-dollar R&D pathway intrinsic to groundbreaking scientific advancement. These growing companies are discovering groundbreaking cures and treatments for devastating diseases; developing advanced biofuels, renewable chemicals, and biobased products; and researching novel gene traits for identifying food sources that could help combat global hunger.

Tax Reform and the Biotech Industry

BIO believes that the tax code should recognize and promote innovation as fundamental to the long-term economic growth of the United States. For the United States to continue to lead the world in the 21st century innovation economy, tax reform must support the growth of small business innovators, incentivize investment in breakthrough technologies, and bolster U.S. companies currently hamstrung by a high corporate tax rate and a burdensome worldwide tax system out of step with the rest of the world.

BIO supports your efforts to streamline the tax code in order to facilitate lower rates and international competitiveness. At the same time, there are provisions in the current code that stimulate biotech R&D and early-stage commercialization (e.g., the R&D Tax Credit and the Orphan Drug Tax Credit), and these provisions are vitally important to the scientific progress of BIO members. Furthermore, Congress has the opportunity in tax reform to take new steps to inspire innovative science by supporting the growth of, and incentivizing investment in, pre-revenue small businesses early in their life cycle. The combination of lower overall rates, strengthened innovation incentives, and targeted small business provisions will support breakthrough research and bolster the 21st century innovation economy.

BIO Contact: Charles H. Fritts
cfritts@bio.org
(202) 962-6690

The Impact of Tax Reform on Small Business Innovation

Innovative companies invest heavily in research and development, leading to scientific breakthroughs and creating both research and manufacturing jobs. The vast majority of small biotech companies are not yet profitable and must continue to seek capital investment to fund their groundbreaking R&D. So, while they do pay federal employment-related taxes, along with various state and local taxes, they are not yet taxpayers on income or revenue. The federal tax code is important to them, though, for two key reasons. First, R&D companies accumulate deferred tax assets during their long development periods without product revenue, including net operating losses (NOLs) and tax credits. Second, the tax code can provide incentives for other companies, individuals, and funds to invest in growing innovators.

Given that emerging companies like those in the biotechnology industry rely heavily on private investment rather than product revenue to fund their promising research, innovation incentives in the current tax code (including the R&D credit) do not provide them with sufficient immediate benefit. Small companies that are pre-revenue are unable to immediately utilize these incentives; instead, they are accumulated as deferred tax assets for use later to offset future profits. This does not reduce operating or capital costs in the present, nor does it facilitate capital formation.

It takes more than a decade and over $2 billion to develop a lifesaving medicine. A lower corporate tax rate, even combined with current tax incentives, will not incentivize much-needed investments in the pre-revenue companies leading the search for new treatments because it will not provide immediate or short-term tax benefits to investors or to the companies themselves. While a lower rate would be helpful to established innovators, it will not stimulate investment in the near term for growing biotechs when they need it most.

As such, BIO supports specific small business incentives to drive innovation by growing companies and to incentivize investment in groundbreaking R&D. The unique nature of innovative companies with very long-term development timelines must be taken into account in tax reform, and the tax code should reflect the needs of these pre-revenue capital-intensive businesses.

Small Business Tax Incentives

Section 469 R&D Partnership Structures

Prior to 1986 tax reform, many growing companies attracted investors by using R&D Limited Partnerships, in which individual investors would finance R&D projects and then utilize the operating losses and tax credits generated during the research process. These structures gave investors a tax incentive to support biotech research, which is entirely dependent on outside investors but often too risky or expensive to attract sufficient investment capital. The enactment of the passive activity loss (PAL) rules in 1986 prevented investors from using a company's losses to offset their other income, thus removing the incentive to support vital research.

BIO supports targeted reforms to Section 469 to allow a limited exception from the PAL rules for R&D-focused pass-thru entities. Under this proposal, small companies would be able to enter into a joint venture with an R&D project's investors. The losses and credits generated by the project would then flow through to the company and investors, who would be able to use the tax assets to offset other income. Relaxing the PAL rules to allow investors to enjoy a more immediate return on their investment, despite the long and risky timeline usually associated with groundbreaking research, would incentivize them to invest at an earlier stage, when the capital is most needed.

This proposal has been introduced on a bipartisan basis in the House by Reps. Patrick Meehan, Richard Neal, Mike Kelly, Ron Kind, and John Larson. Their bill, the PARTNER Act (H.R. 2297), would spur investment in early-stage groundbreaking innovation, and BIO is hopeful that it will be included in any tax reform package.

Section 382 NOL Reform

Innovative companies often have a long, capital-intensive development period, meaning that they can undergo a decade of research and development without any product revenue prior to commercialization. During this time period, companies generate significant net operating losses (NOLs), which can be used to offset future gains if the company becomes profitable. However, Section 382 restricts the usage of NOLs by companies that have undergone an "ownership change." The law was enacted to prevent NOL trafficking, but small biotech companies are caught in its scope – their reliance on outside financing and deals triggers the ownership change restrictions and their NOLs are rendered useless.

BIO supports reform of Section 382 to exempt NOLs generated by qualifying research and development conducted by a small business from Section 382. This change would allow small companies the freedom to raise capital for innovative research without fear of losing their valuable NOLs. Additionally, the ability of a small business to maintain its NOLs makes it more attractive to investors and purchasers looking to take its research to the next level.

Section 1202 Capital Gains Reform

Section 1202 allows investors to exclude from taxation 100% of their gain from the sale of a qualified small business (QSB) stock if they hold the stock for five years. This provision was designed to promote investment in growing businesses, but its overly restrictive size requirements prohibit innovative companies from accessing valuable investment capital. Currently, QSBs must have gross assets below $50 million. The high costs of research, coupled with valuable intellectual property and successive rounds of venture financing, often push growing innovators over the $50 million gross assets limit and out of the QSB definition.

In addition to maintaining the 100% exclusion, BIO supports changing the QSB definition to include companies with gross assets up to $150 million, with that cap indexed to inflation. BIO also supports excluding the value of a company's IP when calculating its gross assets. These changes would allow more growing innovators to attract investors to fund their vital research. Providing incentives to invest in biotech research would increase the innovation capital available to research-intensive businesses and speed the development of groundbreaking medicines.

PATH Act R&D Credit Reforms

The R&D Credit was made permanent by the Protecting Americans from Tax Hikes (PATH) Act in December 2015, and BIO strongly believes it should remain in the reformed tax code. Maintaining this credit would recognize its vital role in supporting America's innovation economy.

BIO also supports maintaining the PATH Act's reform to the R&D Tax Credit that allows pre-revenue innovators to take a portion of their Credit against their payroll tax obligation, an important recognition that income tax credits do not yet benefit pre-revenue companies.

Under current law, companies in their first five years of operation can utilize up to $250,000 in R&D Credits under the PATH Act reforms. While BIO believes this change was an important first step, we would also support expanding the provision, either by extending the eligibility time period (given the long development timelines of groundbreaking innovation) or by expanding the dollar amount of credits available for use (given the high costs of biotech research).

Biofuels Tax Incentives

Since 2009, the advanced biofuels industry has invested billions of dollars to build first-of-a-kind demonstration and commercial-scale biorefineries across the country. Despite the challenges associated with developing new technologies, as of 2015 there were five commercial scale cellulosic biorefineries with a combined capacity of more than 50 million gallons within the United States. Unfortunately, policy instability undermines certainty and predictability for investors and other market participants. The uncertain cycle of expirations and reinstatements for tax incentives for advanced and cellulosic biofuels make it difficult for the industry to take advantage of these tax incentives that could help move these projects to commercial production by attracting investment and reducing the cost of production.

The development of advanced and cellulosic biofuels is a difficult and capital-intensive enterprise. Despite the recent successes of building commercial-scale facilities, this is a new and developing industry. However, there are great benefits to developing these technologies. Over the past 10 years the biofuels industry has displaced nearly 1.9 billion barrels of foreign oil by replacing fossil fuels with homegrown biofuels. This has saved consumers an average of one dollar a gallon at the pump. The use of biofuels has also led to a reduction in U.S. transportation-related carbon emissions of 590 million metric tons over the past decade – an equivalent of removing more than 124 million cars from the road. Even with these benefits, this sector needs predictable federal tax policy to continue to attract investment in order to grow and compete with incumbent industries that have long received favorable tax preferences.

Tax Incentives for Biofuel Innovation

BIO has long supported a suite of tax incentives important for the development of advanced and cellulosic biofuels – the Second Generation Biofuel Producer Tax Credit (PTC), the Special Depreciation Allowance for Second Generation Biofuel Plant Property, the Biodiesel and Renewable Diesel Fuels Credit, and the Alternative Fuel Vehicle Refueling Property Credit. Unfortunately, the PTC and associated depreciation provisions have never been enacted for a sufficient length of time to allow investors to depend upon their existence once the facilities are eventually placed in service. BIO supports the extension of these provisions. Further, BIO would encourage Congress to reject the creation of a phase-out. Ending the tax credits on an arbitrary date in the near term will hamper the utilization of these incentives for an industry where financing and constructing new facilities takes on average five to six years.

Clean Energy Development

If the Committee determines it could best stimulate investment and growth of clean energy development and deployment with a simple, durable, and technology neutral program, it is important the Committee develops a formula that does not inadvertently discriminate against technologies. BIO strongly supports the concept of providing tax incentives on a performance basis rather than arbitrary assignment by statute. With any energy efficiency formula, it may be necessary to provide some extra bonus credits to fuels that achieve a "negative" carbon emissions rating and to fuels that provide socially valuable octane enhancements.

Tax Incentive Eligibility

Technology neutral incentives must also provide developers and investors confidence in the availability of the tax incentives. The Department of Treasury process that determines eligibility of fuels should rely wherever possible upon existing Environmental Protection Agency (EPA) data. However, due to lengthy and unpredictable administrative processes with EPA approval of pathways, which would undermine public confidence in the timely availability of the incentives, BIO suggests that EPA should be encouraged to provide interim data wherever possible that would allow the fuels to become eligible for tax incentives in advance of the multi-year pathway determinations.

To allow for a smooth transition to the new credit program, the definition of "qualifying facility" should be adjusted to provide a uniform 10-year stream of production tax credits for each otherwise eligible facility placed in service before date of enactment. Facilities placed in service after date of enactment would trigger the 10-year period when placed in service. We would like to continue to work with Members of Congress to develop a tax incentive regime for advanced and cellulosic biofuels that reflects the life cycle environmental benefits of those fuels.

Funding for Infrastructure Investment

Should the Committee consider an increase to the excise tax on gasoline to fund infrastructure developments and provide greater funding for highways, which could increase the number of construction and manufacturing jobs in the economy, BIO encourages the Committee to carefully balance incentives to develop innovative biofuels and the necessary distribution infrastructure. Any future increases to the excise tax on gasoline should include a reduced rate for fuels that contain higher levels of ethanol and other biofuels, ranging from E15, which contains 15 percent ethanol, up to E85, which contains 85 percent ethanol. A rate reduction for higher blends of biofuels in the transportation fuel supply will spur greater use of domestically produced renewable fuel. Providing a lower excise tax on fuels containing higher levels of ethanol will spur investments in infrastructure to deploy greater volumes of biofuels and grow market space for advanced and cellulosic biofuels. This will benefit consumers, the nation's economy, infrastructure, rural communities, and energy and national security.

Renewable Chemicals and Biobased Products Tax Incentives

Companies are using industrial biotechnologies to help resolve important challenges in synthesizing new products, whole cell systems, and other biological processes to improve all types of manufacturing and chemical processes. This progress is enabling the production of a new generation of renewable chemicals, biobased products, and bioplastics produced from renewable biomass, which can supplement or substitute for traditional petroleum-based chemicals and products. Given that the U.S. faces the challenge of reducing its costly dependence on foreign oil and competing in a $2.4 trillion worldwide clean energy market with a number of countries already implementing aggressive alternative energy development programs, the emergence of this technology represents a historic opportunity to reverse job losses in the U.S. chemicals and plastics sectors while simultaneously improving energy security and the environment.

Investment and production tax credits are currently offered to incumbent fossil energy industries. As such, tax incentives for renewable chemicals and biobased products are critical to our efforts to attract capital given that these types of incentives are offered to other U.S. energy sectors. It will be more difficult for renewable chemical companies to develop projects in the United States if other nations such as China, Germany, Malaysia, and other BRIC nations offer attractive investment incentives. To realize the industry's potential for domestic job creation and reduced reliance on foreign oil, Congress must ensure that renewable chemical technologies are incentivized in the tax code, and at a minimum receive tax parity with other renewable energy technologies.

Production or Investment Tax Credit for Qualifying Renewable Chemicals

BIO supports the enactment of a production or investment renewable chemicals tax credit, which would create a targeted, short-term tax credit for the production of qualifying renewable chemicals from biomass. Applicants for the tax credit would be evaluated on job creation, innovation, environmental benefits, commercial viability and contribution to U.S. energy independence. Like current law for renewable electricity production credits, the credits would be general business credits available for a limited period per facility. This renewable chemicals tax credit would support innovation and help domestic companies compete in a rapidly growing global renewable chemicals market, revitalize domestic manufacturing, and bring new energy efficient biobased products for consumers. That, in turn, would create millions of new jobs and opportunities for economic growth.

To truly achieve energy security, the U.S. must develop biorefineries that produce alternatives to all of the products made from each barrel of oil. Industrial biotechnology enables the production of renewable chemicals and biobased products from biomass, and the total displacement of fossil fuel products can be accelerated with a production or investment tax credit. The bipartisan reintroduction of the Renewable Chemicals Act (H.R. 3149), offers a strong model for implementation of this proposal.

Master Limited Partnerships Parity Act for Renewable Chemicals & Biofuel Producers

BIO supports the Master Limited Partnerships Parity Act, previously introduced in the 113th and 114th Congresses, which would extend the publicly-traded partnership ownership structure to renewable energy power generation projects, renewable chemicals, and transportation fuels. This bill would amend the Internal Revenue Code to extend availability of the master limited partnership (MLP) business structure in which renewable chemicals and biofuels investors are treated as partners for tax purposes but whose ownership interest can be traded like corporate stock. Availability of the MLP structure would reduce the cost of private capital for renewable chemicals and biofuels projects. BIO supports this important effort to modernize MLP, which is extremely timely given the significant transformation in the nation's energy mix that has occurred over the past two decades.

Reinstating Sec. 48C and Eligibility for Renewable Chemicals and Biobased Products

To realize the full potential of the domestic renewable chemicals industry, existing renewable energy and manufacturing tax incentive regimes should be opened to renewable chemicals. Renewable chemicals and biobased products impact everyday products impacting our economy, such as car parts, cleaning products, soaps, insulation materials, plastics, foams, fibers, and fabrics. BIO urges Congress to incorporate the language of the Make It in America Tax Credit Act of 2011 into any energy or manufacturing tax package discussed and introduced in tax reform.

Conclusion

Congress has the opportunity in tax reform to foster innovation, spur small business investment, and support the growth of an R&D-intensive, modern American economy. In order to create domestic jobs and ensure that the United States maintains its global leadership, tax reform must lower the corporate rate and move towards a territorial system, while preserving innovation-driving incentives such as the R&D and Orphan Drug Tax Credits. But it must go further. Innovation by pre-revenue companies also must be promoted in tax reform if America is going to lead the way in the global economy.

The U.S. biotechnology industry remains committed to developing a healthier American economy, creating high-quality jobs in every state, and improving the lives of all Americans. Tax reform must recognize the unique nature of biotech R&D and the role that small companies play in developing life-saving treatments and addressing America's pressing public health challenges. Tax reform that supports small business innovation will incentivize groundbreaking innovation at growing companies across the country and support American leadership on the world stage.

Comments for the Record
United States House of Representatives
Committee on Ways and Means
Subcommittee on Tax Policy
Hearing on How Tax Reform Will
Help America's Small Businesses Grow and Create New Jobs
Thursday, July 13, 2017, 10:00 A.M.
1100 Longworth House Office Building

By Michael G. Bindner
Center for Fiscal Equity

Chairman Roskam and Ranking Member Doggett, thank you for the opportunity to submit these comments for the record to the Committee on Ways and Means Tax Policy Subcommittee. As usual, we will preface our comments with our comprehensive four-part approach, which will provide context for our comments.

- A Value Added Tax (VAT) to fund domestic military spending and domestic discretionary spending with a rate between 10% and 13%, which makes sure very American pays something.
- Personal income surtaxes on joint and widowed filers with net annual incomes of $100,000 and single filers earning $50,000 per year to fund net interest payments, debt retirement and overseas and strategic military spending and other international spending, with graduated rates between 5% and 25%.
- Employee contributions to Old Age and Survivors Insurance (OASI) with a lower income cap, which allows for lower payment levels to wealthier retirees without making bend points more progressive.
- A VAT-like Net Business Receipts Tax (NBRT), which is essentially a subtraction VAT with additional tax expenditures for family support, health care and the private delivery of governmental services, to fund entitlement spending and replace income tax filing for most people (including people who file without paying), the corporate income tax, business tax filing through individual income taxes and the employer contribution to OASI, all payroll taxes for hospital

insurance, disability insurance, unemployment insurance and survivors under age 60.

These remarks are an update of our recent remarks on how tax reform will grow the economy. The scope of Tax Reform is still in flux, but recent remarks from the President and the Administration indicate that they are supporting more of a rate cut than a basic reform of the system. Recent scoring by the Tax Policy Center does not look good for the proposal.

The proposal includes a rate cut for pass through firms to 15%. This will do what tax reform should not, create sham businesses as a way for rich taxpayers (your donor base) to keep from paying money at a higher rate without actually causing any new economic activity. This will hurt, rather than help, real small businesses who will now be carrying more of the load of taxation for rich people and who would be forced to formally start a business that can utilize these rates in order to keep up with competitors.

Lower marginal tax rates for the wealthiest taxpayers lead them to demand lower labor costs. The benefit went to investors and CEOs because the government wasn't taxing away these labor savings. In prior times, we had labor peace, probably to the extent of causing inflation, because CEOs got nothing back for their efforts to cut costs.

In September 2011, the Center submitted comments on Economic Models Available to the Joint Committee on Taxation for Analyzing Tax Reform Proposals. Our findings, which were presented to the JCT and the Congressional Budget Office (as well as the Wharton School and the Tax Policy Center), showed that when taxes are cut, especially on the wealthy, only deficit spending will lead to economic growth as we borrow the money we should have taxed. When taxes on the wealthy are increased, spending is also usually cut and growth still results. The study is available at

http://fiscalequity.blogspot.com/2011/09/economic-models-available-to-joint.html

The tax reforms detailed here will make the nation truly competitive internationally while creating economic growth domestically, not by making job creators richer but families better off. The Center's reform plan will give you job creation. The current blueprint and the President's proposed tax cuts for the wealthy will not.

Simplicity and burden reduction are very well served by switching from personal income taxation of the middle class to taxation through a value added tax. For these people, April 15th simply be the day next to Emancipation Day for the District. The child tax credit will be delivered with wages as an offset to the Net Business Receipts tax without families having to file anything, although they will receive two statements comparing the amount of credits paid to make sure there are no underpayments by employers or overpayments to families who received the full credit from two employers.

Small business owners will get the same benefits as corporations by the replacement of both pass through taxation on income taxes and the corporate income tax with the net business receipts tax. As a result, individual income tax filing will be much simpler, with only three deductions: sale of stock to a qualified ESOP, charitable contributions and municipal bonds – although each will result in higher rates than a clean tax bill.

The proposed Destination-Based Cash Flow Tax is a compromise between those who hate the idea of a value-added tax and those who seek a better deal for workers in trade. It is not a very good idea because it does not meet World Trade Organization standards, though a VAT would. It would be simpler to adopt a VAT on the international level and it would allow an expansion of family support through an expanded child tax credit. Many in the majority party oppose a VAT for just that reason, yet call themselves pro-life, which is true hypocrisy. Indeed, a VAT with enhanced family support is the best solution anyone has found to grow the economy and increase jobs.

Value added taxes act as instant economic growth, as they are spur to domestic industry and its workers, who will have more money to spend. The Net Business Receipts Tax as we propose it includes a child tax credit to be paid with income of between $500 and $1000 per month. Such money will undoubtedly be spent by the families who receive it on everything from food to housing to consumer electronics.

The high income and inheritance surtax will take money out of the savings sector and put it into government spending, which eventually works down to the household level. Growth comes when people have money and spend it, which causes business to invest. Any corporate investment manager will tell you that he would be fired if he proposed an expansion or investment without customers willing and able to pay. Tax rates are an afterthought.

Our current expansion and the expansion under the Clinton Administration show that higher tax rates always spur growth, while tax cuts on capital gains lead to toxic investments – almost always in housing. Business expansion and job creation will occur with economic growth, not because of investment from the outside but from the recycling of profits and debt driven by customers rather than the price of funds. We won't be fooled again by the saccharin song of the supply siders, whose tax cuts have led to debt and economic growth more attributable to the theories of Keynes than Stockman.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

Contact Sheet

Michael Bindner
Center for Fiscal Equity
14448 Parkvale Road, Suite 6
Rockville, MD 20853
240-810-9268
fiscalequitycenter@yahoo.com

Committee on Ways and Means
Subcommittee on Tax Policy
Hearing on How Tax Reform Will
Help America's Small Businesses Grow and Create New Jobs
Thursday, July 13, 2017, 10:00 A.M.
1100 Longworth House Office Building

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears:

This testimony is not submitted on behalf of any client, person or organization other than the Center itself, which is so far unfunded by any donations.

MAXINE TURNER, CHAIR
SMALL BUSINESS COUNCIL

TOM SULLIVAN, EXECUTIVE DIRECTOR
SMALL BUSINESS COUNCIL

July 12, 2017

The Honorable Peter Roskam
Chairman
Subcommittee on Tax Policy
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Lloyd Doggett
Ranking Member
Subcommittee on Tax Policy
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Roskam and Ranking Member Doggett:

On behalf of the Small Business Council of the U.S. Chamber of Commerce, I am writing to thank you for holding a hearing on the need for tax reform to spur small business growth and create economic prosperity.

The Chamber has already communicated strong support for the Ways and Means Committee's efforts to enact comprehensive reform, and I echo the Chamber's call that the individual and corporate tax codes should be reformed simultaneously to ensure consistency and to promote pro-growth tax policies.[1]

The Chamber is the world's largest business federation. It represents the interests of over three million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. Ninety-six percent of Chamber member companies have fewer than 100 employees and 75 percent have fewer than 10. The Small Business Council works to ensure the views of small business are considered as part of the Chamber's policy-making process.

The company I founded, Cuisine Unlimited, was established more than 37 years ago as a small deli and catering operation in Salt Lake City, Utah. Today, we are a second-generation family owned business with 120 full- and part-time employees offering full catering and events services. We have catered events throughout the country and have been involved with seven Olympic Games. We were the exclusive caterer at USA House for the United States Olympic Committee in Athens and Torino.

As chair of the Small Business Council, I have met with hundreds of small business owners to better understand the U.S. small business landscape. Over the past decade, there have been many obstacles to overcome, including the worst recession since the Great Depression and a multitude of federal mandates and regulations coming from Washington, D.C. The tax code

[1] Letter to Chairman Kevin Brady (May 18, 2017), available at: https://www.uschamber.com/letter/letter-chairman-brady-support-comprehensive-tax-reform.

represents one of the largest barriers for us to overcome in order to expand, create new jobs, and have a positive impact on the economy.

Paramount to reform is tax simplification. A recent study conducted by the U.S. Chamber of Commerce Foundation found that compliance with federal regulations costs the employer community $1.9 trillion per year.[2] Those costs hit small businesses the hardest, with an impact on firms with 50 employees or fewer that is 20 percent higher than the average for all firms.[3] When dealing with the tax code, the cost of compliance has been estimated at $100 billion, with small businesses bearing almost two-thirds of the cost.[4]

In addition to tax simplification, reducing rates is essential to free up capital and allow small businesses to reinvest and grow. Ninety-six percent of American's 29 million small businesses pay taxes as individuals.[5] Those small businesses face a top marginal rate of 39.6 percent, even higher than the anti-competitive 35 percent rate faced by C corporations. Pass-throughs' combined federal and state marginal rates are close to 45 percent.[6]

Our situation at Cuisine Unlimited mirrors numerous examples from businesses throughout the United States and from the businesses presenting testimony before your Subcommittee. Lower rates would allow for us to upgrade our catering facility in Salt Lake City, buy new stoves, and replace some aging delivery vans.

Lowering rates equates to reinvestment in the dreams of entrepreneurs and small business owners on Main Streets across the country. Freeing up capital will enable employers to offer more generous benefits, make technology upgrades, and hire more employees.

The 62 million people employed at small firms represent about half of the nation's private sector workforce. And, since 1995 small businesses are responsible for creating two-thirds of the net new jobs in the country. The power of small business to create growth, spur innovation, hire workers, and improve communities throughout the United States is undisputed. However, an overly complex tax code with anti-competitively high rates is stifling our ability to expand our businesses and grow our communities.

I applaud your Subcommittee for highlighting the importance of tax reform for small business, and I thank you for considering our views in this letter. Please do not hesitate to contact Tom

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[2] "The Regulatory Impact on Small Business: Complex. Cumbersome. Costly," U.S. Chamber of Commerce Foundation (May 2017), available at https://www.uschamberfoundation.org/reports/small-business-regulation-study.
[3] *Id.*
[4] "Taxpayer Compliance Costs for Corporations and Partnerships: A New Look," George Contos, John Guyton, Patrick Langetieg, Allen Lerman, and Susan Nelson, Department of the Treasury, Office of Tax Analysis (Presented at the 2012 Research Conference of the Internal Revenue Service and the Urban-Brookings Tax Policy Center, Washington, DC), available at: https://www.irs.gov/pub/irs-soi/12rescontaxpaycompliance.pdf.
[5] "Frequently Asked Questions About Small Business," U.S. Small Business Administration, Office of Advocacy (June 2016), available at: https://www.sba.gov/advocacy/frequently-asked-questions-about-small-business.
[6] *See* "A Better Way: Our Vision for a Confident America" (June 24, 2016), available at: https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.

Sullivan at the U.S. Chamber of Commerce at (202) 463-3192 for any additional information about the views expressed here.

Sincerely,

Maxine Turner, Founder
Cuisine Unlimited
Salt Lake City, Utah

cc: Members of the Subcommittee on Tax Policy

July 26, 2017

The Honorable Peter Roskam
Chairman
House Committee on Ways and Means
Subcommittee on Tax Policy
2246 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Lloyd Doggett
Ranking Member
House Committee on Ways and Means
Subcommittee on Tax Policy
2307 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Roskam and Ranking Member Doggett:

On behalf of the Coalition to Preserve Cash Accounting ("the Coalition"), we are writing to explain why it is important to continue to allow farmers, ranchers, and service provider pass-through businesses to continue to use the cash method of accounting as part of any tax reform plan. We appreciate the opportunity to provide these comments in connection with the House Ways and Means Subcommittee on Tax Policy's July 13, 2017 hearing on *How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs*. The Coalition applauds your efforts to improve the nation's tax code to make it simpler, fairer and more efficient in order to strengthen the U.S. economy, make American businesses more competitive, and create jobs.

The Coalition is comprised of dozens of individual businesses and trade associations representing thousands of farmers, ranchers, and service provider pass-through entities across the United States that vary in line of business, size and description, but have in common that our members rely on the use of cash accounting to simply and accurately report income and expenses for tax purposes. Pass-through entities account for more than 90 percent of all business entities in the United States. A substantial number of these businesses are service providers, farmers, and ranchers that currently qualify to use cash accounting. They include a variety of businesses throughout America - farms, trucking, construction, engineers, architects, accountants, lawyers, dentists, doctors, and other essential service providers - on which communities rely for jobs, health, infrastructure, and improved quality of life. These are not just a few big businesses and a few well-to-do owners. According to IRS data, there are over 2.5 million partnerships using the cash method of accounting, in addition to hundreds of thousands of Subchapter S corporations eligible to use the cash method.

<u>About the Cash Method of Accounting</u>

Under current law, there are two primary methods of accounting for tax purposes - cash and accrual. Under cash basis accounting, taxes are paid on cash actually collected and bills actually paid. Under accrual basis accounting, taxes are owed when the right to receive payment is fixed, even if that payment will not be received for several months or even several years; expenses are deductible even if they have not yet been paid.

The tax code permits farmers, ranchers, and service pass-through entities (with individual owners paying tax at the individual level) of all sizes - including partnerships, Subchapter S corporations, and personal service corporations - to use the cash method of accounting. Cash accounting is the foundation upon which we have built our businesses, allowing us to simply and accurately report our income and expenses, and to manage our cash flows, for decades. It is a simple and basic method of accounting - we pay taxes on the cash coming in the door, and we deduct expenses when the cash goes out the door. No gimmicks, no spin, no game playing. Cash accounting is the very essence of the fairness and simplicity that is on everyone's wish list for tax reform.

Some recent tax reform proposals would require many of our businesses to switch to the accrual method of accounting, not for any policy reason or to combat abuse, but rather for the sole purpose of raising revenues for tax reform. Forcing such a switch would be an effective tax increase on the thousands upon thousands of individual owners who generate local jobs and are integral to the vitality of local economies throughout our nation. It would also increase our recordkeeping and compliance costs due to the greater complexity of the accrual method. Because many of our businesses would have to borrow money to bridge the cash flow gap created by having to pay taxes on money we have not yet collected, we may incur an additional cost with interest expense, a cost that would be exacerbated if interest expense is no longer deductible, as proposed under the House Republicans' Better Way blueprint ("the blueprint"). Some businesses may not be able to borrow the necessary funds to bridge the gap, requiring them to terminate operations with a concomitant loss of jobs and a harmful ripple effect on the surrounding economy.

Tax Reform Proposals and Cash Accounting

The blueprint moves toward a cash flow, destination-based consumption tax. The cash flow nature of the proposal suggests that the cash method of accounting would be integral and entirely consistent with the blueprint since it taxes "cash-in" and allows deductions for "cash-out," including full expensing of capital expenditures. While we understand that they are different proposals, the "ABC Act " (H.R. 4377), a cash flow plan introduced by Rep. Devin Nunes (R-CA) in the 114th Congress, *required* all businesses to use the cash method. However, the blueprint does not provide details regarding the use of the cash method, including whether all businesses would be required to use it, whether businesses currently allowed to use the cash method would continue to be allowed to do so, whether a hybrid method of cash and accrual accounting would apply, or some other standard would be imposed.

President Trump's tax reform plan is not a cash flow plan and takes a more traditional income tax-based approach, yet the principles articulated in the administration's plan are entirely consistent with the continued availability of the cash method of accounting. Growing the economy, simplification, and tax relief are exemplified by the cash method of accounting. Requiring businesses that have operated using the cash method since their inception to suddenly pay tax on money they have not yet collected, and may never collect, is an effective tax increase, and will have a contraction effect on the economy as funds are diverted from investment in the business to pay taxes on money they have not received or as businesses close because of insufficient cash flow and inability to borrow. It is important to note that cash accounting is not a "tax break for special interests;" it is a simple, well-established and long-authorized way of reporting income and expenses used by hundreds of thousands of family-owned farms, ranches, businesses, and Main Street service providers that are the backbone of any community.

Several recent tax reform proposals, including Senator John Thune's (R-SD) S. 1144, the "Investment in New Ventures and Economic Success Today Act of 2017," would expand the use of cash accounting to allow all businesses under a certain income threshold, including those businesses with inventories, to use cash accounting. Such proposals aim to simplify and reduce recordkeeping burdens and costs for small businesses, while still accurately reporting income and expenses. A few of these proposals (not S. 1144) would pay for this expansion by forcing all other businesses currently using cash accounting to switch to accrual accounting. We do not oppose expanding the allowable use of cash accounting, but it is unfair and inconsistent with the goals of tax reform to pay for good policy with bad policy that has no other justification than raising revenues. When cash accounting makes sense for a particular type of business, the size of the business should make no difference. Further, there have been no allegations that the businesses currently using cash accounting are abusing the method, inaccurately reporting income and expenses, or otherwise taking positions inconsistent with good tax policy.

Tax reform discussions seem to be trending toward faster cost recovery than under current law. For example, the blueprint allows for full expensing of capital investment, Senator Thune's bill makes bonus depreciation permanent, and comments from administration officials suggest that President Trump and his team prefer faster write-offs of capital assets. Such policies benefit capital intensive businesses. However, service businesses by their very nature are not capital intensive, so it would be unfair to allow faster cost recovery for some businesses while imposing an effective tax increase and substantial new administrative burdens on pass-through service providers who will not benefit from more generous expensing or depreciation rules by taking away the use of cash accounting.

<u>Other Implications of Limiting Cash Accounting</u>

In addition to the policy implications, there are many practical reasons why the cash method of accounting is the best method to accurately report income and expenses for farmers, ranchers, and pass-through service providers:

> <u>The accrual method would severely impair cash flow.</u> Businesses could be forced into debt to finance their taxes, including accelerated estimated tax payments, on money we may never receive. Many cash businesses operate on small profit margins, so accelerating the recognition of income could be the difference between being liquid and illiquid, and succeeding or failing (with the resulting loss of jobs).
>
> <u>Loss of cash accounting will make it harder for farmers to stay in business.</u> For farmers and ranchers, cash accounting is crucial due to the number and enormity of up-front costs and the uncertainty of crop yields and market prices. A heavy rainfall, early freeze, or sustained drought can devastate an agricultural community. Farmers and ranchers need the predictability, flexibility and simplicity of cash accounting to match income with expenses in order to handle their tax burden that otherwise could fluctuate greatly from

one year to the next. Cash accounting requires no amended returns to even out the fluctuations in annual revenues that are inherent in farming and ranching.

Immutable factors outside the control of businesses make it difficult to determine income. Many cash businesses have contracts with the government, which is known for long delays in making payments that already stretch their working capital. Billings to insurance companies and government agencies for medical services may be subject to being disputed, discounted, or denied. Service recipients, many of whom are private individuals, may decide to pay only in part or not at all, or force the provider into protracted collection. Structured settlements and alternative fee arrangements can result in substantial delays in collections, sometimes over several years; therefore, taxes owed in the year a matter is resolved could potentially exceed the cash actually collected.

Recordkeeping burdens, including cost, staff time, and complexity, would escalate under accrual accounting. Cash accounting is simple - cash in/cash out. Accrual accounting is much more complex, requiring sophisticated analyses of when the right to collect income or to pay expenses is fixed and determinable, as well as the amounts involved. In order to comply with the more complex rules, businesses currently handling their own books and records may feel they have no other choice than to hire outside help or incur the additional cost of buying sophisticated software.

Accrual accounting could have a social cost. Farmers, ranchers, and service providers routinely donate their products and services to underserved and underprivileged individuals and families. An effective tax increase and increased administrative costs resulting from the use of accrual accounting could impede the ability of these businesses to provide such benefits to those in need in their local communities.

Conclusions

The ability of a business to use cash accounting should not be precluded based on the size of the business or the amount of its gross receipts. Whether large or small, a business can have small profit margins, rely on slow-paying government contracts, generate business through deferred fee structures or be wiped out through the vagaries of the weather. Cash diverted toward interest expense, taxes, and higher recordkeeping costs is capital unavailable for use in the actual business, including paying wages, buying capital assets, or investing in growth.

Proposals to limit the use of cash accounting are counterproductive to the already agreed-upon principles of tax reform, which focus on strengthening our economy, fostering job growth, enhancing U.S. competitiveness, and promoting fairness and simplicity in the tax code. Accrual accounting does not make the system simpler, but more complex. Increasing the debt load of American businesses runs contrary to the goal of moving toward equity financing instead of debt financing and will raise the cost of capital, creating a drag on economic growth and job creation. Putting U.S. businesses in a weaker position will further disadvantage them in comparison to foreign competitors. It is simply unfair to ask the individual owners of pass-through businesses to shoulder the financial burden for tax reform by forcing them to pay taxes on income they have not yet collected where such changes are likely to leave them in a substantially worse position than when they started.

As discussions on tax reform continue, the undersigned respectfully request that you take our concerns into consideration and not limit our ability to use cash accounting. We would be happy to discuss our concerns in further detail. Please feel free to contact Mary Baker (mary.baker@klgates.com) or any of the signatories for additional information.

Thank you for your consideration of this important matter.

Sincerely,[1]

Americans for Tax Reform
American Council of Engineering Companies
American Farm Bureau Federation
American Institute of Certified Public Accountants
American Medical Association
The American Institute of Architects
The National Creditors Bar Association
Akin Gump Strauss Hauer & Feld LLP
Baker Donelson
Debevoise & Plimpton LLP
Dorsey & Whitney LLP
Foley & Lardner LLP
Jackson Walker L.L.P.
K&L Gates LLP
Kilpatrick Townsend & Stockton LLP
Lewis Roca Rothgerber Christie LLP
Littler Mendelson P.C.
Miles & Stockbridge P.C.
Mitchell Silberberg & Knupp LLP
Morrison & Foerster LLP
Nelson Mullins Riley & Scarborough LLP
Ogletree, Deakins, Nash, Smoak & Stewart, P.C.
Perkins Coie LLP
Quarles & Brady LLP
Rubin and Rudman LLP
Squire Patton Boggs (US) LLP
Steptoe & Johnson LLP
White & Case LLP

[1] Although not a signatory to this letter, the American Bar Association (ABA) is working closely with the Coalition and has expressed similar concerns regarding proposals to limit the ability of personal service businesses to use cash accounting. The ABA's most recent letters to the House Ways & Means and Senate Finance Committees are available here and here.

Statement for the Record
House Committee on Ways and Means
Subcommittee on Tax Policy
Hearing on "How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs"

July 13, 2017

Stephanie Silverman
President & Chief Executive Officer
Employee-Owned S Corporations of America
1341 G Street, NW, 6th Floor
Washington, DC 20005

On behalf of the Employee-Owned S Corporations of America (ESCA), thank you for the opportunity to submit comments to the House Committee on Ways and Means Tax Policy Subcommittee. We commend the Committee for its continued focus on policies to drive the economy thru tax policy and job growth, which is essential to not only the industry, but also to working Americans, their families and their communities.

About ESCA

ESCA represents private employee-owned companies operating in every state across the nation, in industries ranging from heavy manufacturing to construction to grocery stores. The expansion of subchapter S corporation employee stock ownership plans (S ESOPs), following Congress' creation of that structure in 1998, is testimony to the fact that this business model offers a valuable way to transition ownership, empower workers and boost productivity.

Currently, there are about 3,000 S corporation ESOPs, many of which are small businesses, employing 470,000 workers across the country and supporting nearly a million jobs in all. We would respectfully suggest to the Committee that a vital means of encouraging the success of small businesses is to expand the availability of S corporation ESOPs through targeted tax policy updates.

Employee Ownership as a Transition Tool to Keep Jobs Local

Alex Brill, CEO of Matrix Advisors, who served as policy director and chief economist on the Ways and Means Committee staff, noted in his March 2017 paper, *Employee Stock Ownership Plans as an Exit Strategy for Private Business Owners*, "With Baby Boomers owning roughly half of private businesses, there is a wave of ownership changes on the horizon that has the potential to impact workers across the economy. For certain private business owners, a way to preserve a firm's continuity, foster employee commitment, and build lasting economic value in a community is to sell the business to its employees through an ESOP."

By selling to an ESOP, these businesses can remain open and vital parts of their communities, while providing retirement savings for their new employee-owners and job opportunities for future employee-owners. As the Ways and Means Committee contemplates pro-growth measures, ***we urge members to support tax policies that expand the availability of S corporation ESOPs, allowing more workers to own their businesses and benefit from the advantages that employee ownership holds***.

H.R. 2092

Toward that end, H.R. 2092 -- introduced in April by Committee members Dave Reichert and Ron Kind along with Reps. Pat Tiberi, Richard Neal, Erik Paulsen, Earl Blumenauer and Bill Pascrell -- would help to grow the number of private ESOP businesses in the United States, giving more workers the opportunity to build savings, reduce wealth and wage inequality, and retire with dignity. The measure includes provisions to extend the gain-deferral provisions of Code section 1042 to sales of employer stock to S ESOPs, encourage the flow of bank capital to ESOP-owned S corporations, provide resources to small businesses contemplating making the transition to an ESOP, and ensure that SBA-certified small businesses do not lose their status by becoming employee owned. Last Congress' version of this legislation, H.R. 2096, had 96 bipartisan cosponsors (including 22 members of the Ways and Means Committee).

S ESOPs Promote Jobs and Savings

The evidence is compelling that expanding the availability of S corporation ESOPs for more companies and their workers would not only boost the retirement savings of countless Americans, but would also create more jobs, generate more economic activity, and help businesses be more stable and successful.

A 2016 study by Jared Bernstein showed that ESOP companies provide more stable employment than other businesses, pay better wages and reduce wealth inequality. A 2015 study by EY's Quantitative Economics and Statistics practice found that S ESOPs outperformed the S&P 500 in total return per participant by an impressively large margin (62%) and distributions to participants totaled nearly $30 billion from 2002 to 2012. A 2008 University of Pennsylvania/Wharton School of Business study found that S ESOPs contribute ***$14 billion in new savings for their workers each year beyond the income they would otherwise have earned,*** and that these companies offer workers greater job satisfaction and stability. The study also found that S ESOPs generate a collective ***$19 billion in economic value that otherwise would not exist.***

S corporation ESOPs are doing exactly what Congress intended for companies large and small: generating economic activity, creating jobs, and promoting retirement savings. By any measure, these companies have been a remarkable success story, and a bright spot in an economy characterized over the course of the last decade or more by sluggish growth, anemic job creation, worker insecurity and wealth inequality.

Economic Security for Employee-Owners

One of the clearest benefits of job stability and strong savings among workers is how they feel about their own economic security and the evidence also tells us there is a marked difference between ESOP employees and other workers, with ESOP employees expressing less worry and more confidence about their fiscal health. A new survey by John Zogby Strategies found that employees who work at private, employee-owned companies feel more financially secure and feel they have more job security than other workers, whose economic anxiety continues to grow by comparison. The survey benchmarked responses against the annual "Economic Anxiety Poll" put out by Marketplace/Edison Research. The survey also found these employee-owners feel financially stable enough that they worry less about being able to cover expenses – mortgage and rent payments, student loan costs or unexpected costs – than does the rest of the population.

Conclusion

Given the clear and compelling benefits to workers, communities, businesses and the national economy that are derived from S ESOPs, there is little doubt that a practical solution to the question at hand is to spur the creation of more S ESOPs and create more employee-owners. With that goal in mind, we look forward to working with Subcommittee members to advance provisions from H.R. 2092 this year. We thank the Subcommittee for its continued championship of employee ownership through the S ESOP model, and more broadly for its work on pro-growth policies for working Americans at small businesses.

The Employee-Owned S Corporations of America ("ESCA") is the Washington, DC voice for employee-owned S corporations. ESCA's exclusive mission is to advance and protect S corporation ESOPs and the benefits they provide to the employees who own them. These companies have an important story to tell policymakers about the tremendous success of the S ESOP structure in generating long-term retirement savings for working Americans and their families. ESCA provides the vehicle and the voice for these efforts. ESCA represents employee-owners in every state in the nation.

2017 FEUSA Family Business Survey

March 2017

Family Enterprise USA (FEUSA) is a 501(c)(3) organization dedicated to educating the public and creating an environment where private family business is valued and strengthened.

The FEUSA Family Business Survey is conducted annually to update lawmakers on the facts about and priorities of family businesses each year and to further our efforts to grow public support for hard working family-owned businesses across America.

HOW YOU CAN HELP: Membership in FEUSA is open to all family businesses. Please contact Mike Hamra or Pat Soldano of the FEUSA Board at www.familyenterpriseusa.com to find out how you can join, provide financial support and work with FEUSA to help educate legislators in your community and on Capitol Hill.

2017 FEUSA Survey Administered by:

About this Survey

- Family Enterprise USA (FEUSA) is a 501(c)(3) organization dedicated to educating the public and creating an environment where private family business is valued and strengthened.
- The FEUSA Family Business Survey is conducted to update lawmakers on the facts about and priorities of family businesses each year, and to further our efforts to grow public support for hard working family-owned businesses across America.
- FEUSA retained Family Office Exchange (FOX) to coordinate participant outreach and administer the 2017 FEUSA Family Business Survey. This report captures data from 186 family-owned businesses that completed the online survey from February 23 to March 17, 2017.
- Sample sizes are noted for each question. If you have questions or comments about the data and analysis presented herein, please contact FEUSA Board Chair, Mike Hamra at mhamra@teamhamra.com, or Pat Soldano at pmsoldano@policyandtaxationgroup.com, FEUSA Board Member.
- FEUSA and Family Office Exchange are grateful to the university-based family business centers, Family Office Exchange members, and trusted advisors to family businesses who helped spread the word about this survey and, most of all, to the family business leaders who took time to share their perspectives by completing this survey.

About the Participants

- The majority of survey participants (60%) are either sole owner or majority owner of a business that generates up to $50 million in annual revenue. While most businesses operate in the U.S., 17% also have operations in other countries.
- Half of business owners employ 50 employees or less; 35% have anywhere from 51 to 1,000 employees.
- Survey participants have businesses in all industries, including real estate (12%), manufacturing (11%) and food and beverage (10%).

Long-term Commitment to their Businesses and Communities

- Half of the participants have first and second generation businesses, while the other half are third generation or beyond. Most (65%) have multiple generations of the family working together in the business. Eighty-one percent (81%) consider their business to be part of the legacy they leave their children.
- About 40% have passed on partial or full ownership of the business to the next generation. Those who have not transitioned to the next generation are either working on a succession plan, do not want to give up ownership yet, or their children are not interested in the business.
- Most (76%) saw their business revenue grow in 2016 and are confident about the business' ability to increase revenue each year. Consequently, 72% plan to hire additional employees in 2017, an increase from 66% in 2016.
- Aside from creating jobs, 92% of business owners pursue civic engagement by sharing their time, talents and resources in their communities.

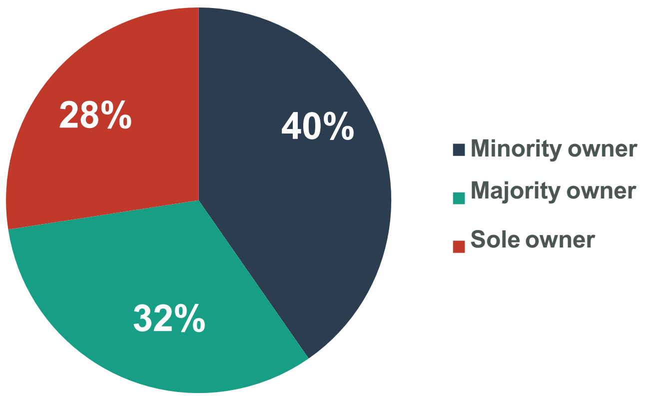
Challenges & Concerns

- While participants are confident in their ability to grow their business, their top concerns include reducing income taxes, reducing regulations and minimizing or eliminating estate taxes.
- Seventy-eight (78%) of participants see external influences such as government regulation, tax policy and the economic environment as a greater threat to their sustainability than internal issues, such as family conflict.
- About 19% of business owners indicate that planning for estate taxes affects their ability to add jobs. In 2016, they incurred an average of $74,940 in insurance for estate taxes, an average of $170,800 in other estate tax planning costs and an average of 13% of their time was spent planning for estate taxes.
- Business owners share, in their own words, the impact of the regulations on their business. The common themes are around estate taxes costing money, resources and time that they could have put into growing their business.
- Understanding their concerns, it is no surprise that 63% of business owners find it more challenging to operate their businesses today than it was five years ago. This is significant because 21% of participants say they would have hired more employees if they did not have to spend resources on estate tax.

SURVEY DEMOGRAPHICS

Nature of Business Ownership

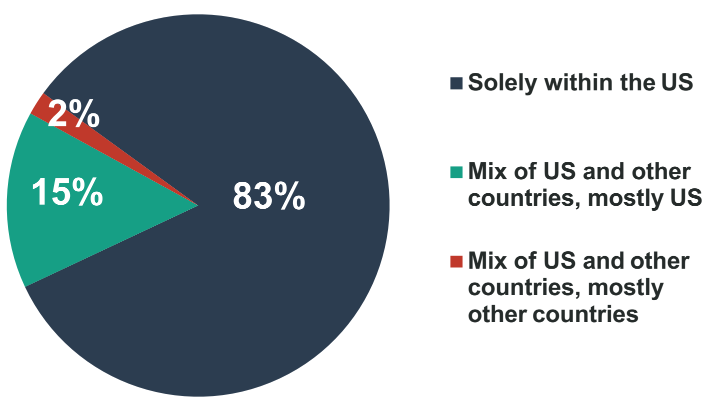
n=186



70% of respondents are C-suite executives in the business.

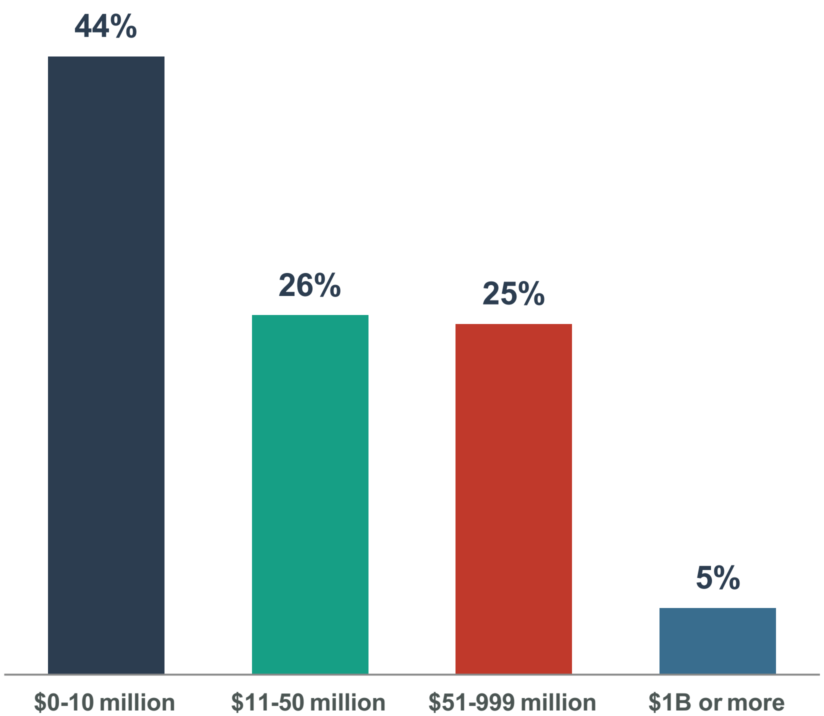
Does the family business operate exclusively in the United States?

n=170



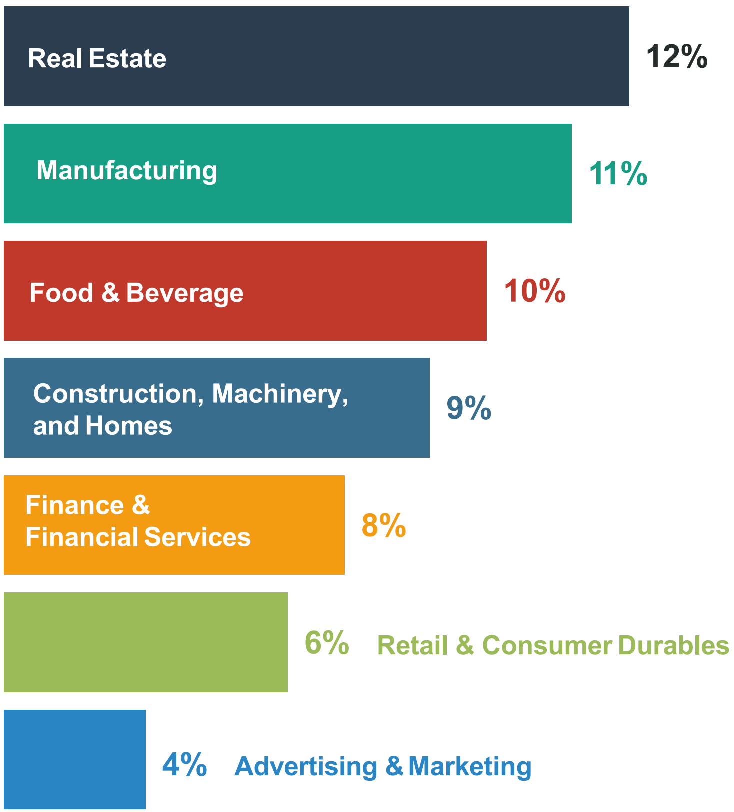
What was the business' annual revenue for 2016?

n=167



Which of the following best describes the principal industry of your family business?

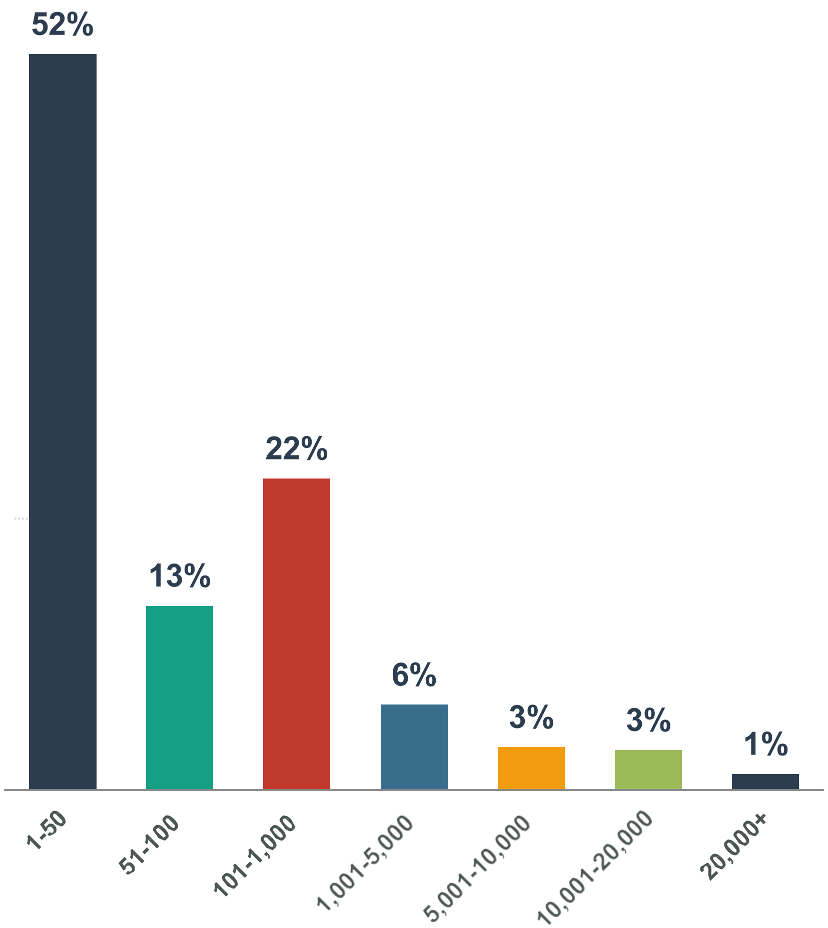
n=177



The remaining 39% of participants represent industries ranging from education and agriculture to healthcare and transportation.

How many employees work for your family business?

n=178



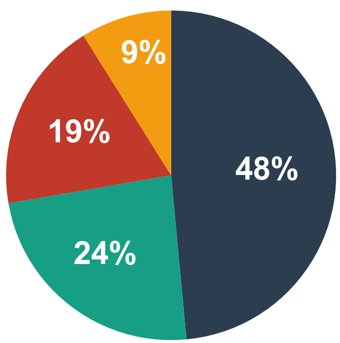
Do you have liquid wealth outside of the business?

n=164

YES 68% | **NO 32%**

How do you manage this liquid wealth?

n=111



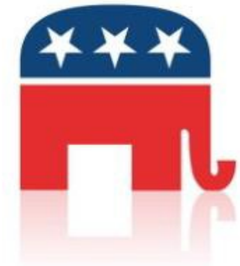
- Single family office
- We oversee a number of wealth advisors
- Other*
- Multi-family office

*Other includes investment advisor and self-directed.

How do you identify yourself politically?

n=163

55%



12%

27%

6% Other, which includes Libertarian, Conservative, undecided and declined to share.

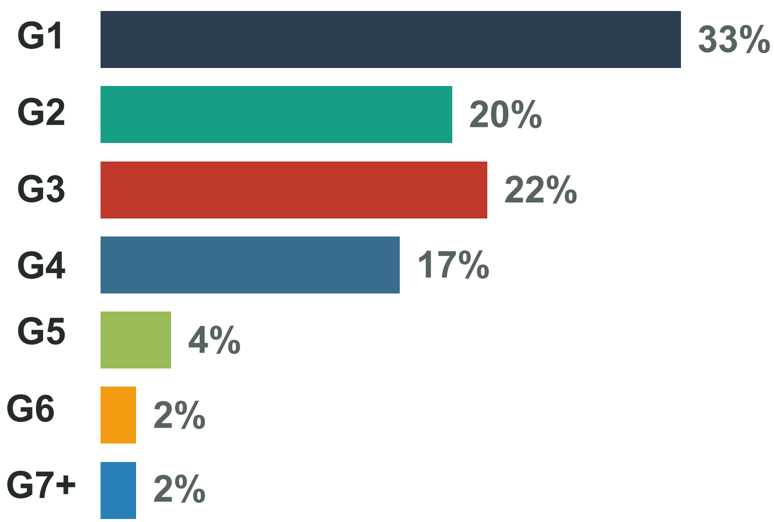
BUSINESS LEADERSHIP

Commitment to Business and Family

Family Enterprise USA

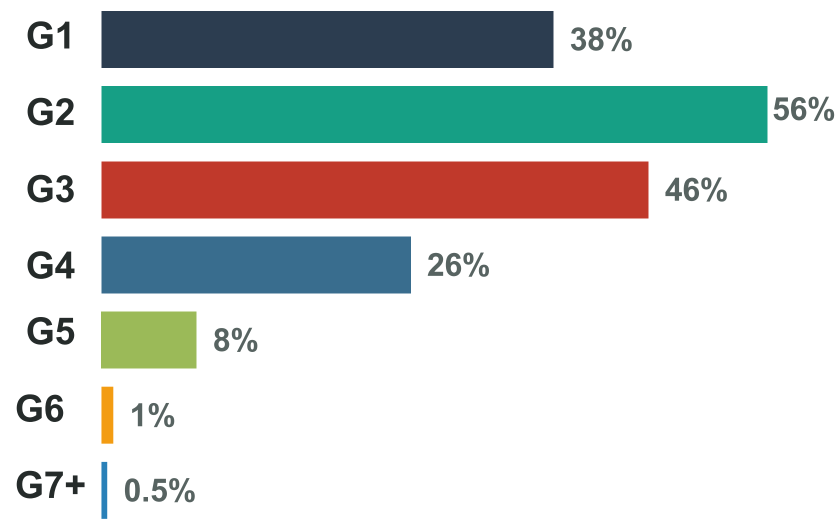
What generation is your family business?

n=181



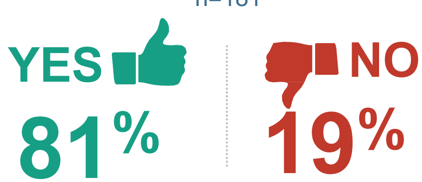
Which generations are active in the family business? *Select all that apply*

n=181



Do you consider your family business to be part of your legacy to your children?

n=181

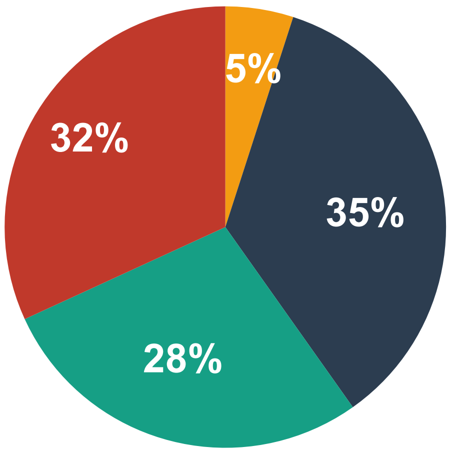


Keeping It In the Family

- **25%** of participants have defied the parable of "shirt sleeves to shirt sleeves in three generations" and have businesses that have been in the family for four or more generations.
- **65%** of respondents have multiple generations of family members working together in the family business.

Have you passed ownership of the business on to the next generation?

n=178



- Yes, full ownership including controlling and non-controlling shares
- Yes, partial ownership
- No, but have a succession plan in place
- No, and have not yet started to develop a succession plan

Out the business owners who passed ownership of the business on to the next generation, the **majority (76%)** gifted it while 42% sold it.

Please share the reasons you have not passed ownership of the business to the next generation.

n=87

- Working on succession plan
- Lack of interest of the next generation
- Kids not prepared yet / Kids too young
- Founder not ready to transition to next generation
- Not sure where, when and how to start

Strong Leadership

Family Enterprise USA

52% of participants have Governing Board

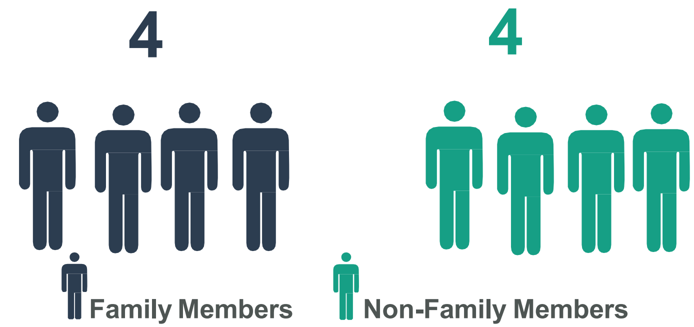
n=183

15% are considering forming one
33% do not have a governing board

66% of those with a governing board rely on both family and external, independent board members.

Average Number of Members Serving on a Governing Board

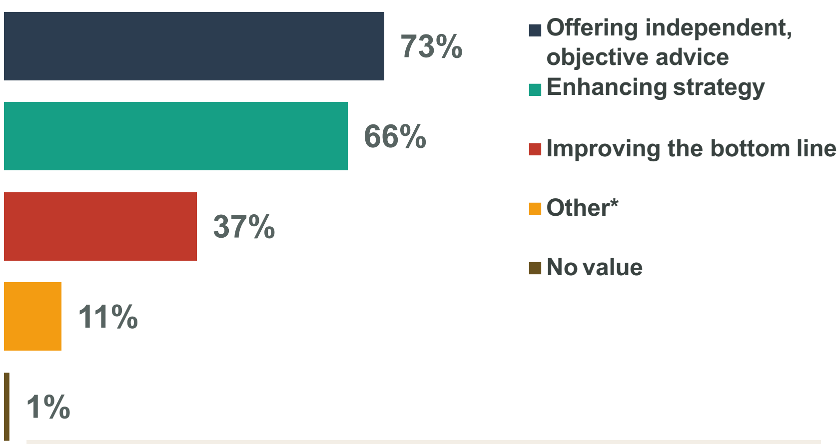
n=76



64% of participants rely on other business owners to serve as board members on their governing boards.

How has the board been helpful to your business?

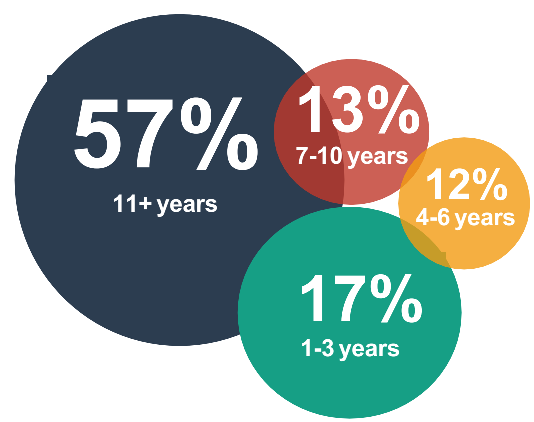
n=81



*Other includes mentoring, governance and training.

How long has your board been in operation?

n=81



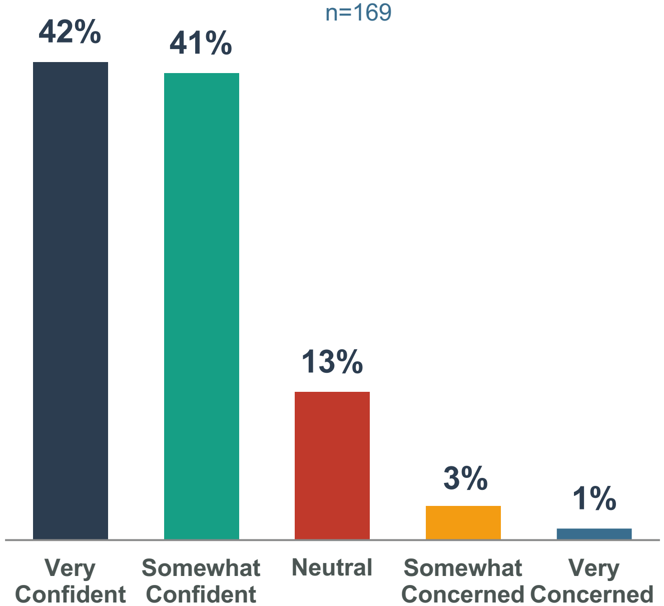
BUSINESS CONCERNS & CHALLENGES

Confident about Revenue Growth

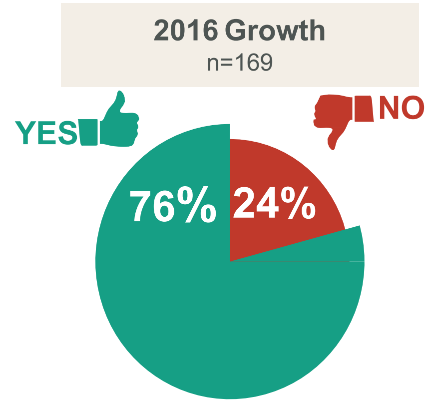
Family Enterprise USA

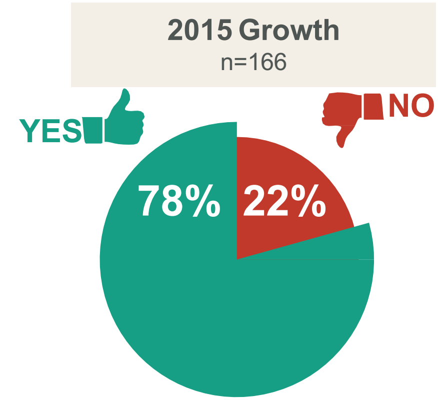
Confidence in Business's Ability to Increase Revenue Each Year

n=169



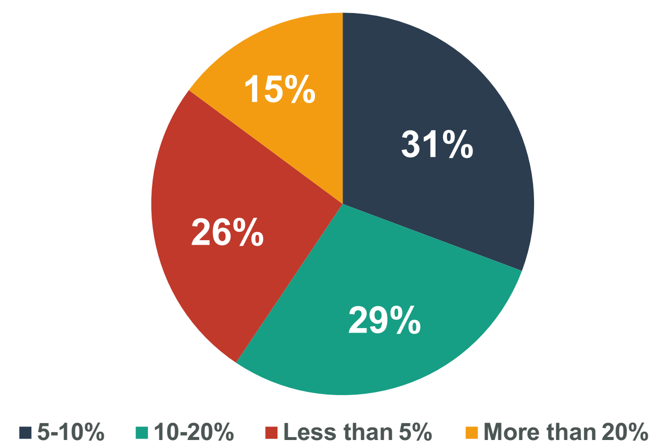
Did Your Business Revenue Grow?





2016 Revenue Growth

n=124

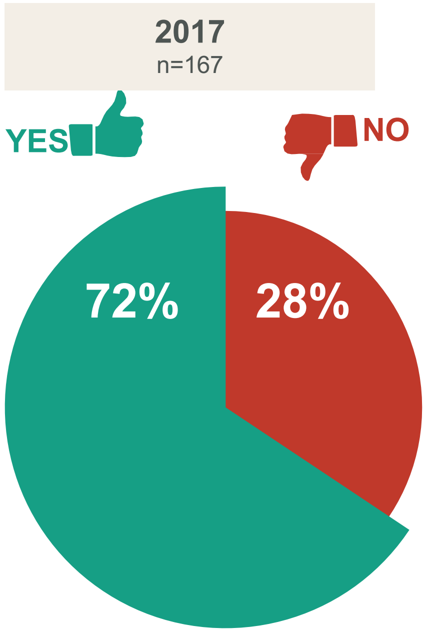


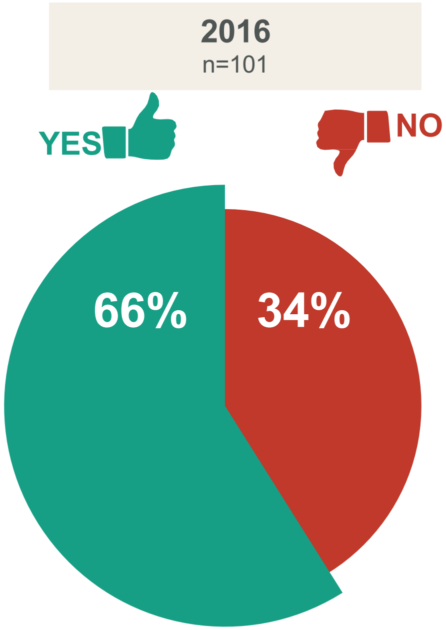
Confidence in Continued Growth

- Similar to 2015, **more than half** of the respondents report revenue growth in 2016. This is down from 81% in 2014. The majority (60%) reported growth rates between 5-20%.
- **83%** of respondents are confident about their ability to increase revenue each year, in spite of their concerns about government regulations and taxes.

Intention to Hire More Employees

Do you plan to hire more employees?





Revenue Growth Leads to Job Growth

- In 2011, just **33%** of participants reported job growth. In 2017, **72%** of respondents planned to add employees compared to **66%** in 2016.
- **97%** of the respondents that are hiring new employees in 2017 plan to add up to 100 new employees (compared to 90% in 2016).
- **73%** of business owners said they plan to add approximately 50 jobs in the **next 10 years**.

Contributing to Communities

Family Enterprise USA

How do you or your business pursue civic engagement? n=163

Contributing money to one or more charitable organizations	89%
Volunteering personal time in the community	72%
Serving on the board of a non-profit and/or charitable organization	68%
Making in-kind donations of materials, supplies, space, etc.	61%
Encouraging employees to volunteer their time in the community	59%
Operating a family foundation that directs philanthropic activities	36%
Contributing money to one or more political organizations or political candidates	33%
Giving a set percentage of company profits to charitable organizations	25%

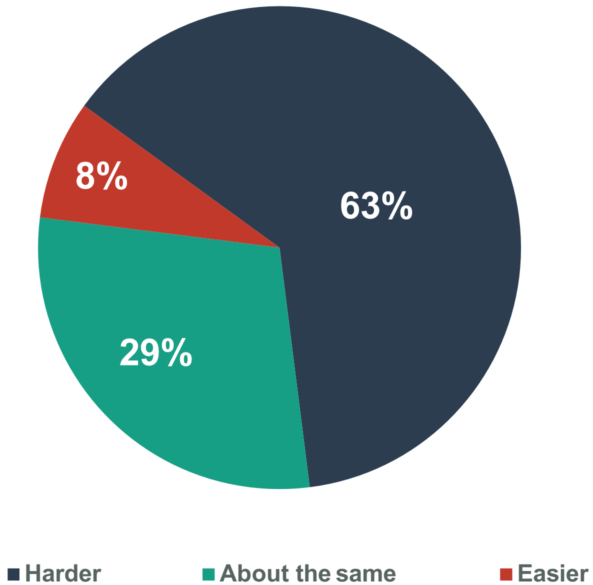
Positive Impact on their Communities

- **96%** of respondents give back to their communities by sharing their time, talents and resources in the ways outlined above.
- From volunteering their own time **(72%)** to encouraging their employees to volunteer in the community **(59%)**, family business owners invest in their communities.

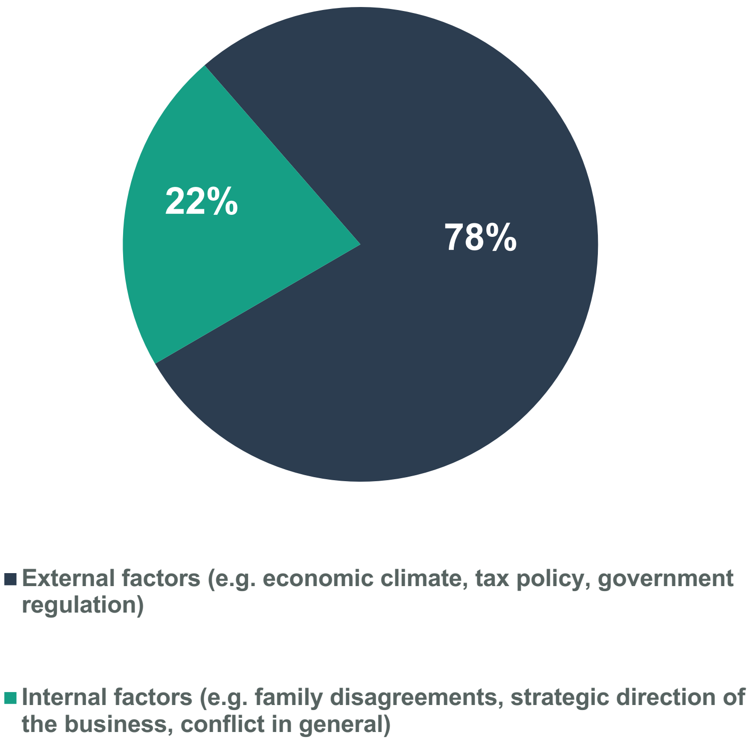
Harder to Operate a Family Business in America

Family Enterprise USA

Over the past five years, has it gotten easier or harder to operate your family business?
n=166



Which do you believe to be the greater threat to the future success of your family business? n=165



Top Concerns – Reducing Taxes & Regulations

Please rate your level of concern about the following issues on a scale of: 1 (Not at all concerned) to 5 (Very concerned) n=165

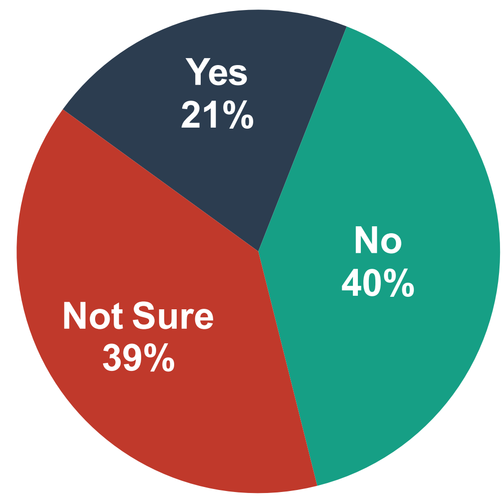
	Weighted Average
Reducing income taxes	4.1
Reducing regulations	4.0
Reducing or eliminating estate taxes	3.9
Simplifying the tax code	3.8
Reducing capital gains taxes	3.8
Reducing the federal budget deficit and national debt	3.2

The Impact of Estate Taxes

About 19% of respondents indicate that planning for estate taxes affects their ability to add jobs, which increased from 10% in 2015.

Average cost of insurance to pay for estate taxes in 2016 n=17	**$74,940**
Average other costs incurred to plan for estate taxes in 2016 n=19	**$170,800**
Average percentage of time spent planning for estate taxes in 2016 n=32	**13%**

If you did not have to set aside assets for the estate tax, would you have added more jobs in your company?
n=167



Family Enterprise USA

What would you like lawmakers to know about the impact of estate taxes on your business?

- *"The uncertainty of future estate/gift/GSTT tax rules, rates and thresholds requires significant time and cost (consultants) and wasted efforts to educate and re-educate family members taking away from business activities (development of new products and services) and finding, training and hiring qualified people in the immediate and surrounding communities."*
- *"If estate taxes were totally repealed, the positive impact would be that I would spend the savings and the savings in time spent, on new projects to improve the business."*
- *"Estate taxes hamper succession and reduce our chances for surviving this generation. Option is to sell out and that basically kills a productive, independent business."*
- *"Changes the current look at opportunities because we MUST maintain a certain amount of extra liquidity. Will force us to downsize our business, sell assets and reduce staff when deaths occur."*
- *"Estate taxes stifle growth and development, as well as impact succession possibilities that could allow a business to successfully transition ownership from generation to generation, and serve communities in perpetuity."*
- *"It reduces our ability to invest in the company, to grow and employ people."*
- *"It diverts attention from growing the business and adding more jobs."*
- *"The uncertainty of potentially having a big bill to pay at an uncertain time causes us to maintain more liquid assets when our business is largely real assets."*
- *"It impacts our ability to grow the business and add new jobs. It also creates uncertainty, and, for us, much of the money ends up being paid to consultants such as attorneys and CPAs versus creating jobs for hard working Americans."*

Mission and Approach

Family Enterprise USA (FEUSA) is dedicated to educating the public about the implications of public policy upon closely held and family-owned businesses. FEUSA conducts non-partisan research that highlights the contributions of family enterprises to the economy and the challenges these businesses face, which is then used to educate. This research provides the foundation for FEUSA to educate the public and opinion leaders on the important role of family businesses in the economy and local communities.

Impact and Focus

FEUSA is the go-to organization in Washington for information on the family business industry. FEUSA has established itself as a trusted resource through its two major projects, which will continue to be expanded upon:

- Capital City Fly-In: Twice a year, FEUSA gathers supporters in Washington, D.C., to hear updates on the organization's latest work and developments and learn the state of federal policy impacting businesses. The supporters then meet with legislators to discuss FEUSA's work, and educate them on the current economic environment businesses around the country face.
- FEUSA Annual Survey: Through its annual Family Business Survey, FEUSA has distinguished itself as an expert in data collection in the family business sphere. The data provides the foundation for executing FEUSA's mission.

Over the coming years, FEUSA will continue to grow by conducting research in specific areas of tax policy that impact family-owned businesses. A primary focus will be researching the effects of the estate tax. FEUSA will explore the following topics in measuring estate tax impacts:

- Compliance Costs
- Environmental Impact
- Minority Wealth

Family Enterprise USA is uniquely positioned to provide the non-partisan intelligence, data, and educated arguments that opinion leaders will need in the coming years to elevate the debate around tax policies that influence family businesses. Family Enterprise USA's research and work will be instrumental to solidifying FEUSA as the leading organization in Washington working on behalf of family-owned companies.

About Family Office Exchange

Sara Hamilton founded FOX in 1989 to provide objective information and advice on family wealth, family leadership, and different pathways available to sustain wealth across generations. Helping members preserve and enhance their true family wealth by providing education, insights, and peer exchange is the sole focus of FOX. The firm's success is measured by the quality and value of the experience of its many private investors, family offices, multi-family offices, and wealth advisor members. True to this original vision, FOX strives to address new challenges and to provide insights on current trends and issues regarding investing, philanthropy, and owner education. As an advocate for wealth owners, FOX provides leadership in the private wealth field, helping to shape the industry and develop standards of performance for industry professionals.

FOX serves family groups and their advisors in 20 countries, providing trusted insight and best practices for managing family wealth. The network includes 480 ultra-wealth families, as well as 280 multi-family offices (MFOs) and advisory firms. More than 6,000 individual family members are served by the FOX global community.

Members rely on FOX (www.familyoffice.com) to help them make better, more informed decisions about their family legacy and their wealth management practices and providers. FOX has established a safe, confidential environment of common interest and mutual trust to enable members to compare experiences and learn from the collective knowledge of other members in the network. Resources available to FOX members include proprietary research on wealth management best practices, peer benchmarking, bi-monthly webinars on current trends, and an extensive library of articles and white papers, as well as online discussion forums, regional peer roundtables, and a variety of educational workshops and forums.

FOX offers five forums a year for members. The Forums address many of the issues of greatest concern to wealthy families and their advisors in the areas of legacy and leadership. Perhaps most valued by members is the collective intelligence of the FOX network. This accumulated wisdom has been methodically captured by the FOX staff, with full respect for confidentiality and discretion, and archived in a secure searchable database for the exclusive use of FOX members. This collective knowledge is what truly sets FOX apart.

Family Enterprise USA

Enterprising families. Working together.

1775 Pennsylvania Avenue, NW, Suite 350 ▪ Washington, DC 20006 USA

www.familyenterpriseusa.com

POLICY
AND
TAXATION
GROUP

The Honorable Peter Roskam
U.S. Congressman, Sixth District of Illinois
2246 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Roskam,

I write to you on behalf of Family Enterprise USA (FEUSA) – a 501(c)(3) organization dedicated to educating the public and creating an environment where private family business is valued and strengthened. As the House Ways and Means Tax Policy Subcommittee considers how tax reform will help America's small business grow and create jobs, we feel it is important to highlight one policy in particular that we feel inhibits small business growth: the estate tax.

To help further our organization's mission, each year FEUSA conducts the Family Business Survey to update lawmakers on the facts about and priorities of family businesses and to grow public support for hard working family-owned businesses across America. As you will see in the results of our most recent survey (attached as Exhibit A), tax policy – especially as relates to the estate tax – is among the top concerns of many of those business owners who we surveyed. In fact, results show just how much of a negative impact the estate tax has on small and family-owned businesses. For example:

- Approximately 19% of business owners indicate that planning for estate taxes affects their ability to add jobs.
- Survey participants incurred an average of $74,940 in insurance for estate taxes and an average of $170,800 in other estate tax planning costs; they also spent an average of 13% of their time planning for estate taxes.
- 63% of business owners find it more challenging to operate their businesses today than five years ago.
- 21% of survey participants indicated they would have hired more employees if they did not have to spend resources on the estate tax.

Though reducing income taxes and reducing regulation ranked as survey participants' biggest concerns (numbers one and two, respectively) in terms of challenges facing their businesses, the third highest and most specific concern identified in the survey is elimination of the estate tax.

As one survey participant said “*Estate taxes stifle growth and development, as well as impact succession possibilities that could allow a business to successfully transition ownership from generation to generation, and serve communities in perpetuity.”*

In sum, if Congress wants to move forward with tax reform in a way that creates policies that allow small businesses to grow and create jobs, repeal of the estate tax must be part of the solution.

Thank you for your consideration of this important policy change – we stand ready to serve as a resource to you and Committee members and staff and are happy to provide any additional information or answer any questions you may have.

Sincerely,

Pat Soldano,
Board Member

Freedom Partners Chamber of Commerce
2300 Wilson Blvd., Suite 500
Arlington, VA 22201
Tel: (571) 858-2958
Fax: (571) 431-6146

June 13, 2017

Dear Chairman Roskam,

I write today on behalf of the nationwide members of Freedom Partners Chamber of Commerce to express our strong support for pro-growth, comprehensive tax reform that will bring much-needed relief to American small businesses, which are vital instruments of economic growth and job creation in this country.

Under the current system, small businesses are being crushed by high tax rates and a complex, convoluted code that takes too much of small businesses' hard-earned money and makes it difficult and expensive for them to comply each year. Our small businesses deserve better, and we can deliver relief to them through comprehensive tax reform this year.

According to the Small Business Administration, more than half of Americans either own or work for a small business. But these essential businesses spend too much of their time and money complying with the overly complex tax code. Small business owners spend 40 hours—an entire workweek—preparing their federal taxes each year. And only 12 percent of small businesses file taxes on their own—most spend thousands of dollars paying a professional to prepare the return for them.

This drag on the small business economy must be stopped. Simplicity should be a key focus of tax reform efforts: fewer brackets, the elimination of most loopholes and deductions, and more predictability through the elimination of short-term "patches" and "extenders" will ease the heavy compliance burden currently handicapping small businesses.

In addition to dealing with complexity, tax reform must lower our uncompetitive tax rates currently imposed on all businesses, including small businesses. Whether these businesses are taxed at the corporate rate, or at individual rates as pass-through entities, our businesses are unable to compete in the global economy because of our excessively high tax rates—some of the highest in the world. Countries around the world have been racing to lower their business taxes in recent years, while the rates in the U.S. remain among the highest. Lower rates would help ignite economic growth and allow our companies to once again be leaders in the global marketplace.

Finally, we strongly urge this committee to abandon the misguided Border Adjustment Tax proposal, as it would be a grave threat to all industries, and the small business community is particularly vulnerable. This tax would place a huge burden on American importers and consumers—more than $1 trillion in new taxes in the first ten years. 95 percent of our importers are small businesses employing fewer than 250 workers. These small businesses that rely heavily on imports can't afford such a substantial tax increase on a crucial part of their business. They would ultimately be forced to increase their prices for consumers, lay off employees, or close their doors. BAT would only work to undermine any positive, pro-growth reforms if it is included in the final package.

Many in Congress have argued that tax reform simply cannot be done without BAT because we need it to pay for other provisions, specifically full and immediate expensing of capital investments. Full expensing has very high costs in the first ten years—more than $2 trillion—and would benefit a very particular business operation, only new capital investments.

While this change would allow businesses to take investment deductions sooner, it would not actually increase the deduction they can take. On the other hand, lower tax rates can substantially increase after-tax profits year after year. Because the long-term, consistent and equitable value of rate reductions significantly outweighs the benefits of full expensing, we encourage this committee to follow the example of the White House tax plan and drop both the BAT and full expensing, focusing instead on lowering tax rates as far as possible for all businesses.

Freedom Partners will continue to push for our vision of positive, pro-growth tax reforms that will deliver relief to every American this year. We see a tremendous opportunity to overhaul our tax system for both businesses and individuals, and are excited about the potential economic growth that our country would see as a result. We urge your committee to seriously consider the recommendations we have made here, and to follow through on your promise to deliver a tax code that is fairer, flatter, and simpler; one that works for every American individual and business, including our nation's vital small businesses.

Sincerely,

Nathan Nascimento

Nathan Nascimento
Vice President of Policy,
Freedom Partners Chamber of Commerce

CC: Members, House Ways and Means Committee

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515–6315

July 24, 2017

The Honorable Peter Roskam
Chairman, Subcommittee on Tax Policy
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Roskam:

As Chairman of the House Committee on Small Businesses, I commend you on your "How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs" hearing. Compliance with the United States tax code is a major concern for small businesses throughout the nation.

With over 29 million small businesses in the United States,[1] the health of the economy is intricately linked to the nation's smallest employers. Recently formed businesses are responsible for creating two out of every three new jobs. If a new job is created in your community, there is a good chance it was born out of a small business. Beyond job creation, small businesses are a main driver of innovation for the economy. In fact, when it comes to patents, small-young firms acquired 2.41 times as many patents as compared to large-young firms for every dollar spent on research and development.[2] Whether it is in their garage or a university laboratory, entrepreneurs are constantly striving to create the next great American company. Each step small businesses take in their quest drives the economy forward.

However, despite signs of an improving economy, small businesses still face hurdles that prevent job creation and expansion. As Chairman, I hear from small businesses on a daily basis about the sacrifices they make in order to sell an additional product or offer an additional service. Their stories are inspiring. Hard work is not a goal for these individuals, rather it is a reality. Notwithstanding the hours they invest in their work, challenges exist that prevent growth. Unfortunately, data indicates the severity of the problem. On average since the Great Recession,

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[1] SBA OFFICE OF ADVOCACY, SMALL BUSINESS PROFILE (2017), *available at* https://www.sba.gov/sites/default/files/advocacy/United_States_1.pdf.
[2] JOSE PLEHN-DUJOWICH, PRODUCT INNOVATIONS BY YOUNG AND SMALL FIRMS, SBA OFFICE OF ADVOCACY (2013), *available at* https://www.sba.gov/sites/default/files/files/rs408tot.pdf.

new business closings or deaths have outnumbered new business starts or births.[3] More poignantly, job creation by firms less than a year old went from over 4.7 million jobs created in 1999 to 3 million jobs created in 2015.[4]

While many hurdles stand in their way, small businesses continue to point to the burdensome nature of the country's tax code as a major roadblock. Within the NFIB's Small Business Problems & Priorities 2016 report, five of the top ten concerns for small businesses are tax related.[5] From the complexity to the uncertainty, complying with the United States tax code continues to disallow a robust small business ecosystem.

As small business owners and employees develop a new idea and launch their product or service into the marketplace, they often do not have a team of tax advisors on staff or on retainer to handle the implications that arise with the tax code. They are simply in the mindset of creating, producing, and selling a product or service. Once launched, the small business owner is confronted with a tidal wave of tax compliance decisions and issues.

While simultaneously confronting tax issues, not to mention regulatory challenges, the pioneering small business owner must continue the operations of the business. However, breaking even or turning a profit often takes years to realize. The treatment of net operating losses in the tax code presents problems for young small businesses. Any tax reform discussion should be mindful of how a small business, that may take years to grow and expand, might be impacted by the treatment of business losses.

Beyond net operating losses, the complexity of the depreciation schedules prohibit small business expansion. Although Section 179[6] of the tax code helps, too many expanding small businesses fall through the cracks and pivot away from investment opportunities due to the rules that govern how an investment is deducted and for how long. Certainty and clarity should be front and center as talks surrounding depreciation are considered.

Moreover, with 90 percent of all businesses in the United States classified as a pass-through entity[7], and therefore their taxes are administered through individual tax returns, all deep and comprehensive conversations must take into account how an overwhelming majority of businesses calculate their taxes. Looking beyond percentages, in 2014, over 20 million businesses were sole proprietors, compared to roughly 2.5 million C corporations.[8] Not only are

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[3] ECONOMIC INNOVATION GROUP, DYNAMISM IN RETREAT: CONSEQUENCES FOR REGIONS, MARKETS, AND WORKERS (2017), *available at* http://eig.org/wp-content/uploads/2017/07/Dynamism-in-Retreat-A.pdf.

[4] U.S. BUREAU OF LABOR STATISTICS, BUSINESS EMPLOYMENT DYNAMICS, ENTREPRENEURSHIP AND THE U.S. ECONOMY (April 28, 2016), *available at* https://www.bls.gov/bdm/entrepreneurship/entrepreneurship.htm.

[5] HOLLY WADE, NFIB SMALL BUSINESS PROBLEMS AND PRIORITIES (2016), *available at* http://www.nfib.com/assets/NFIB-Problems-and-Priorities-2016.pdf.

[6] 26 U.S.C. § 179.

[7] SCOTT GREENBERG, PASS-THROUGH BUSINESSES: DATA AND POLICY, FISCAL FACT, TAX FOUNDATION (Jan. 2017).

[8] *Id.*

pass-throughs more voluminous than C corporations in sheer numbers, but they are also recording more net income.[9]

The country runs on the hard work of small businesses. When you walk into a local Main Street store, you know the determination it takes to turn the lights on every day. It is not an easy task, yet millions of small businesses persevere against many odds. As the House Ways and Means Committee continues to discuss tax reform, I know you will keep small businesses at the forefront of the conversation, because when small businesses are growing and expanding, so does the economy.

Sincerely,

Steve Chabot
Chairman
Committee on Small Business

[9] *Id.*

Insured Retirement Institute
1100 Vermont Avenue, NW I 10th Floor
Washington, DC 20005

t I 202.469.3000
f I 202.469.3030

www.IRIonline.org
www.myIRIonline.org

July 14, 2017

The Honorable Peter Roskam	The Honorable Lloyd Doggett
Chairman, Subcommittee on Tax Policy	Ranking Member, Subcommittee on Tax Policy
House Committee on Ways and Means	House Committee on Ways and Means
2246 Rayburn House Office Building	2307 Rayburn House Office Building
Washington, DC 20515	Washington, DC 20515

Re: House Committee on Ways and Means, Subcommitee on Tax Policy, July 13, 2017 Hearing:"How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs"

Dear Chairman Roskam and Ranking Member Doggett:

The Insured Retirement Institute[1] (IRI) is pleased to submit this letter to you and request that it be entered into the record for the June 13, 2017 hearing on how tax reform can help America's small businesses grow and and create new jobs. We are submitting this letter to supplement the previous input IRI provided to you and the full committee on April 17, 2017[2] in which IRI detailed our policy proposals about how the tax code should treat retirement savings in tax reform. Our letter highlights the proposals we have put forward to specifically address the challenges that small businesses face as they seek to provide their employees with retirement

[1] IRI is the leading association for the retirement income industry. IRI proudly leads a national consumer coalition of more than 30 organizations and is the only association that represents the entire supply chain of insured retirement strategies. IRI member companies include major insurers, asset managers, and broker-dealers/distributors that account for 95 percent of annuity assets in the United States, with more than 150,000 financial professionals serving over 22.5 million households in communities across the country. As a not-for-profit organization, IRI provides an objective forum for communication and education, and advocates for the sustainable retirement solutions Americans need to help achieve a secure and dignified retirement. IRI is guided in its views by a tax reform task force with active participation by more than 30 of IRI's largest member companies.

[2] IRI's letter of April 17, 2017 may be accessed through the following link: http://www.myirionline.org/docs/default-source/press-release/iri-tax-reform-letter-to-house-tax-writers-04-17-2017-final.pdf?sfvrsn=4

benefits, contribute to our nation's ecnomic growth and generate jobs in communities all across the nation.

Tax Reform Should Maintain the Current Tax Treatment for Retirement Savings that Fuel Small Business and Overall Economic Growth

The way that retirement savings, including annuities, employer-sponsored retirement plans and individual retirement accounts are treated in the tax code today help to foster very significant investments in U.S. equities and bonds which provide vital capital to small businesses that spur economic growth. IRI urges that the current treatment for retirement savings be maintained in tax reform so as to allow small businesses to continue to grow, create jobs and provide their employees with a secure and dignified retirement. To further allow small businesses to enhance their contributions to our nation's economic growth, reforms to the tax code should also include retirement security enhancements and simplification provisions that will help small businesses collectively play an even greater role as the primary engine of our nation's economy.

To illustrate the importance of protecting the current treatment of retirement savings in the tax code and enacting targeted provisions to increase the role that that retirement savings can play in fueling small business and overall economic growth, we thought it important to note that:

- 75 to 85 percent of Baby Boomers, Gen-Xers, individual annuity owners and households with defined contribution plans say current treatment of retirement savings in the tax code are important to their retirement savings.[3]

- Annuities, employer-provided retirement plans and IRAs play a key role in the U.S. economy by producing $25 trillion of retirement assets (34 percent of all U.S. household

[3] Examples include the following: 1) A survey of households with defined contribution plans indicates that tax treatment is "a big incentive to contribute" for 80 percent of households, with 44 percent of households indicating "I probably wouldn't save for retirement if I didn't have a retirement plan at work." *BrightScope and Investment Company Institute, "Americans Views on Defined Contribution Plan Saving, 2016," JCI Research Report (February 2017).*; 2) More than 75 percent of Baby Boomers say that tax deferral is an important incentive – especially for younger and middle-income Boomers. *Insured Retirement Institute, Boomer Expectations for Retirement 2015, Fifth Annual Update on Retirement Preparedness of the Boomer Generation (2015).*; 3) Nearly eight in 10 GenXers (those born between 1965 and 1981) consider tax deferral an important aspect of a retirement investment, and 25 percent of GenXers would be less likely to save for retirement if tax deferral were reduced or eliminated. *Insured Retirement Institute, Don't You (Forget About Means), Third Biennial Study on the Retirement Readiness of Generation X (2016).* ; and 4) According to a recent survey of individual annuity owners (80 percent of whom have household incomes under $100,000), 86 percent said existing tax incentives were an important factor in choosing to purchase their annuity, and 70 percent said they saved more for retirement because of the tax treatment. *The Gallup Organization and Mathew Greenwald & Associates, 2013 Survey of Owners of Individual Annuity Contracts (Conducted for The Committee of Annuity Insurers) (2013).*

assets).[4] 71 percent of U.S. pension assets are invested in equities and bonds, predominantly from the U.S.[5]

- 75 million American families rely on annuities and other life insurers' products for peace of mind, long-term savings, and a guarantee of lifetime income and receive annual benefits of $179.6 billion. The insurance industry, annuities and other insurers' products generate 2.5 million U.S. jobs, invest $5.9 trillion (90 percent of industry assets) in our economy and hold 20 percent of all U.S. corporate bonds.[6]

<u>Tax Reform Should Enact Targeted Provisions that will Help Small Businesses Provide Expanded Retirement Security, Reduce Costs and Liabilities, and Promote Increased Growth</u>

Our current tax code presents many challenges for small businesses which is affecting their ability to positively impact ecnomic growth of our nation. For example, small businesses who want to provide a retirement plan as a benefit to their employees, which can help small business owners attract and retain quality and loyal employees, often are unable to do so, because the costs, regulations and potential liability of offering this benefit make it difficult for them to do so. To address this challenge, IRI supports changing several provisions in the tax code, which we detail below, as part of tax reform to help small businesses thrive and grow. The provisions would have only very modest impact on revenue and all but one (simplification) were included in the *Retirement Enhancement Savings Act of 2016* [(RESA) - S. 3471] which passed the Senate Finance Committee by a 26-0 vote in September 2016.

Multiple Employer Plans: One of the challenges faced by small businesses who seek to offer a retirement plan to their employees are the financial and administrative burdens, as well as legal risks that result from current law, if they offer a retirement plan to employees. As a result of these budens and risks, many are discouraged and fearful of the consequences of non-complicance and therefore, do not offer retirement savings benefits for their employees. One way to overcome this challenge would be to change current law to allow unrelated small businesses to band together to offer a Multiple Employer Plan (MEP) for retirement savings. MEPs will help many small businesses to offer retirement benefits and as a result, allow them

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[4] Investment Company Institute*, The U.S. Retirement Market, Third Quarter 2016.*

[5] Willis Towers Watson, *Global Pension Assets Study 2017* (January 30, 2017).

[6] American Council of Life Insurers, *Insurers and Your State 2017*. (The statistics above are among several cited relating to insurance industry contributions to retirement security and economic growth in *Insurers and Your State 2017*, which indicates the following sources for the statistics cited: "Sources: ACLI calculations based on National Association of Insurance Commissioners (NAIC) 2015 annual statement data; U.S. Bureau of Economic Analysis, 2015 data; U.S. Census Bureau, 2015 data; U.S. Bureau of Labor Statistics, 2015 data; and U.S. Treasury Department, 2015 data.")

to more effectively compete with larger entities at home and abroad who do provide those benefits.

By changing the current law, it will enable those small businesses to take advantage of the administrative and legal efficiencies offered by MEPs, allow small businesses owners to offer workplace retirement savings plans and help them attract and retain employees with a retirement savings benefit that would be competitive with those offered by larger employers.

IRI supports including expanded access to MEPs as part of tax reform for small businesses and recommends that the “open MEPs” provision contained in RESA be included in tax reform legislation.

Annuity Selection Rules: Employers, particularly small business employers, need clear rules about how to select lifetime income products in their retirement plans. By providing this guidance it will enable more small business owners to have the confidence that they are in compliance with their fiduciary responsibilities required by law.

Most employers, especially small business owners, do not have the expertise to make the decisions required by current regulations. This creates uncertainty, raises concerns about liability and discourages employers from offering valuable lifetime income options in their retirement plans.

IRI supports the enactment of a provision, such as the one included in RESA, to address this problem. It would provide the employers with the certainty they need in having met their fiduciary duty, if they select products of insurers that meet certain existing regulatory requirements, such as minimum capital and reserving standards.

Annuity Portability: Due to a technicality in the tax code, employees who invest in lifetime income options through an employment-based retirement plan would lose the guarantees associated with those investments if their employer changes record-keepers. To avoid this result, many employers simply choose not to offer lifetime income options.

IRI supports the inclusion of the provision included in RESA that would make annuities portable by treating the record-keeping change as a distributable event to ensure that workers are not harmed.

Simplification: Small employers can derive significant benefits from streamlining and improving rules and reducing costs associated with a small business owner who provides their employees with retirement benefits. IRI supports including targeted simplification proposals in tax reform that will particularly benefit small businesses. Specifically, we advocate including provisions which:

- Direct the Department of the Treasury and the Department of Labor to consolidate a series of overlapping notices required to be provided to participants under the rules regarding nondiscrimination safe harbors, automatic enrollment arrangements, fee disclosures and default investments.

- Modernize and streamline electronic delivery rules and allow sponsors to make electronic delivery the default delivery option for benefit notices.

Small Employer Plan Start-Up Credit: Small business owners will also be helped if the current tax code's non-refundable income tax credit by which employers with 100 or fewer employees receive a tax credit for start-up costs if they adopt a new qualified retirement plan is increased. In addition, this credit provides additional benefits if the plan provides for automatic enrollment.

IRI supports the proposal to increase the Small Employer Plan Start-Up Credit, included in RESA and urges that the provision be considred for inclusion in tax reform to help small business owners provide a retirement plan for their employees.IRI appreciates your consideration of our tax reform policy proposals to help small business owners and stimulate growth of our nation's economy.

If you have any questions or if we can provide any assistance throughout this important process, please feel free to contact me or any of the following: Lee Covington, IRI's Senior Vice President and General Counsel (lcovington@irionline.org); Paul Richman, IRI's Vice President of Government Affairs (prichman@irionline.org); or Kelli McMorrow, IRI's Vice President of Federal Affairs (kmcmorrow@irionline.org).

Sincerely,

Catherine J. Weatherford
President & CEO
Insured Retirement Institute

Cc: Members of the House Committee on Ways and Means

IYBA INTERNATIONAL YACHT BROKERS ASSOCIATION

July 17, 2017

The Honorable Kevin Brady
Chair, House Ways & Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady:

As your committee considers overhauling the federal tax system, the International Yacht Brokers Association write to request the inclusion of reforms that will create thousands of well-paying American jobs and remove policy that discriminates against U.S. residents and businesses.

Currently, if the owner of a foreign-built vessel wants to sell it in the U.S. to a U.S. citizen, that owner must pay a duty for the right to enter U.S. waters. This happens before a sale is made or a buyer is even sought. Because it often takes up to two years to sell a used vessel, foreign owners do not want to take the risk of paying a duty and leaving U.S. waters without making a sale. Although customs bonds are available for yachts offered for sale at U.S. boat shows, those bonds are for yachts 79ft or larger and prohibit owners from using their yachts in U.S. waters and carry other significant restrictions that deter owners from using them.

The current policy is discouraging about $2.46 billion in U.S. economic activity that could be generating thousands of well-paying American jobs. Furthermore, many owners are not selling their yachts in the United States, resulting in lost sales, lost tax revenue, and lost jobs. For every boat sold in the U.S., studies show that up to 13% of the value of the boat is invested in retrofitting the boat after the sale. In addition, for each year the boat is in U.S. waters, another 10% of the value of the boat is added to our economy in keeping the boat afloat. The jobs created are high wage, blue collar, permanent jobs that will help the entire Marine industry thrive in the U.S. That is why HR 2369, introduced by Representatives Lois Frankel and Ted Yoho, has the support of the Marine industry, including the National Marine Manufacturers Association (NMMA).

Reforms allowing sellers of used, foreign-built vessels to defer payment of any duty owed until after a sale is actually made and allowing transactions to take place both in and out of boat shows will incentivize those owners to bring their vessels to the U.S. creating U.S. jobs and allowing a policy that is fair to U.S. citizens. HR 2369 has been reintroduced and has already gained significant bipartisan support in the House.

The International Yacht Brokers Association looks forward to working with the House Ways & Means Committee and please contact Omar Franco at OFranco@bplegal.com for additional information.

Sincerely,

International Yacht Broker Association

Cindy Sailor
IYBA
1845 Cordova Rd., #205
Ft. Lauderdale, FL 33316
P: 954-522-9270/F: 954-764-0697
cindy@iyba.yachts

Staley Weidman
The Catamaran Company
2019 S.W. 20th St., Suite 300 B
Ft. Lauderdale, FL 33315
P: 954-494-7569/F: 954-727-0024
staley@catamarans.com

Paul Flannery
SYS Yacht Sales
318 S. U.S. Hwy 1
Jupiter, FL 33477
P: 904-607-0099
paul@sysyacht.com

Jeff Erdmann
Denison Yacht Sales
850 N.E. 3rd St., #205
Dania Beach, FL 33004
P: 954-763-3971/F: 954-763-3940
je@denisonyachtsales.com

Bob Denison
Denison Yacht Sales
850 N.E. 3rd St., #205
Dania Beach, FL 33004
P: 954-829-8295/F: 954-763-3940
bob@denisonyachtsales.com

Jenny Wicker
Rick Obey & Associates
2525 Marina Bay Drive E., #202
Ft. Lauderdale, FL 33312
P: 561-212-6663/F: 954-530-5713
jenny@rickobeyandassociates.com

Jason Dunbar
Luke Brown Yachts
1500 Cordova Rd., #200
Ft. Lauderdale, FL 33316
P: 954-525-6617/F: 954-525-6626
jason@lukebrown.com

Gary Smith
SYS Yacht Sales
1306 Main St.
Sarasota, FL 34236
P: 941-321-1705/F: 941-328-8081
gary@sysyacht.com

Grant Henderson
Sanlorenzo of the Americas
1515 S.E. 17th St., #125
Ft. Lauderdale, FL 33316
P: 786-390-2782/F: 954-318-0642
Grant@SanlorenzoAmericas.com

Bruce Schattenburg
Denison Yacht Sales
1535 S.E. 17th St., #119
Ft. Lauderdale, FL 33316
P: 954-328-4329 /F: 954-763-3940
bs@denisonyachtsales.com

David Maass
Alley, Maass, Rogers & Lindsay, P.A.
340 Royal Poinciana Way, #321
Palm Beach, FL 33480
P: 561-659-1770/F: 561-833-2261
david.maass@amrl.com

Gigi Garcia
Grande Yachts International
821 N.E. 3rd St.
Dania Beach, FL 33004
P: 954-478-0564
gigi@grandeyachts.com

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115TH CONGRESS
1ST SESSION

H. R. 2369

To amend the Tariff Act of 1930 to provide for a deferral of the payment of a duty upon the sale of certain used yachts, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

MAY 4, 2017

Ms. FRANKEL of Florida (for herself, Mr. YOHO, Mr. FRANCIS ROONEY of Florida, Mr. DEUTCH, Mr. DIAZ-BALART, Mr. HASTINGS, Mr. DESANTIS, Mr. THOMAS J. ROONEY of Florida, and Mr. MAST) introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Tariff Act of 1930 to provide for a deferral of the payment of a duty upon the sale of certain used yachts, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DUTY UPON SALE OF CERTAIN USED YACHTS.

(a) IN GENERAL.—Title IV of the Tariff Act of 1930 (19 U.S.C. 1401 et seq.) is amended by striking section 484b and inserting the following:

"SEC. 484b. DUTY UPON SALE OF CERTAIN USED YACHTS.

"(a) IN GENERAL.—Notwithstanding any other provision of law, any used yacht that has a valid cruising license under the laws of the United States may enter, may be offered for sale in, and may remain in, the customs territory of the United States without the payment of duty, except that—

"(1) if the used yacht, while in the customs territory of the United States, is sold to a resident of the United States—

"(A) entry of the used yacht shall be completed and duty shall be deposited with U.S. Customs and Border Protection within 15 days after the date on which the sale is completed; and

"(B) any yacht broker or dealer involved in the sale shall collect the duty and remit the duty to U.S. Customs and Border Protection within 15 days after the date on which the sale is completed; and

"(2) duty on the sale of a yacht described in paragraph (1) shall be calculated at the applicable rate provided under the Harmonized Tariff Schedule of the United States and shall be based upon the value of the yacht at the time of sale.

"(b) NO POSTING OF BOND.—No bond may be required to be posted, upon entry of a used yacht into the customs territory of the United States, for the duty otherwise payable on the entry of a used yacht to which subsection (a) applies.

"(c) DEFINITION.—As used in this section, the term 'used yacht' means a vessel that has been sold, before the vessel is brought into the customs territory of the United States, by a manufacturer or dealer to a retail consumer and that is used primarily for recreation or pleasure.

"(d) REGULATIONS.—The Commissioner responsible for U.S. Customs and Border Protection may issue such regulations as may be necessary to carry out this section.".

(b) RELATIONSHIP TO HARMONIZED TARIFF SCHEDULE.—Additional U.S. Note 1 to chapter 89 of the Harmonized Tariff Schedule of the United States is amended by inserting ", subject to section 484b of the Tariff Act of 1930 (19 U.S.C. 1484b)" after "payment of duty".

SEC. 2. EFFECTIVE DATE.

The amendments made by section 1 shall apply to vessels entering the customs territory of the United States on or after the 15th day after the date of the enactment of this Act.

○

SUPPORTERS OF DEFERRED IMPORTATION

NMMA
National Marine Manufacturers Association

BoatU.S.
Boat Owners Association of The United States

Marine Industries Association of Florida, Inc.

Marine Industries Association of South Florida

YBAA
Association of Yacht Sales Professionals

California Yacht Brokers Association – CYBA Member

Young Professionals in Yachting – YPY – Ft. Lauderdale

Gulf Coast Yacht Brokers Association

Northwest Yacht Brokers Association

Northwest Marine Trade Association

LYBRA
Large Yacht Brokers Association

Alley, Maass, Rogers & Lindsay, P.A.

Moore & Company

RobertAllen Law
The Business of Yachts

Hatteras

EdgeWater

Westport

Christensen

Lazzara Yachts

Viking Yachts

Trinity Yachts

U.S. Superyacht Association

Palmer Johnson

Derecktor

Burger

Show Management

YachtWorld.com

Delta

International Crew Training

boats.com

Cable Marine
Founded in 1977

MTN

Bradford Marine
Since 1966

Voyager Maritime Alliance Group

Roscioli Yachting Center

Boat Trader

Raven Marine
Quality Yacht Management

PartnerShips
Yacht Management & Crew Services

Lauderdale Marine Center

YachtCloser

BOW
Everything Marine!

Allied Marine
A Ferrettigroup Company

Denison yacht sales

Galati Yacht Sales

Camper & Nicholsons International
Yachting since 1782

Fraser Yachts

HMY Yachts

Atlantic Yacht & Ship Inc.

Northrop & Johnson

Sarasota Yacht & Ship

iyc
International Yacht Collection

MarineMax

Gilman Yachts
since 1968

LYS

The Catamaran Company

Outer Reef Yachts

Merle Wood & Associates
Specialists in the sale, purchase, charter & construction of the world's finest yachts

Ardell
Specializing in yacht brokerage since 1958

Irwin yacht sales

26° North Yachts

Chamberlain Yachts International

Luke Brown Yachts

Tom George Yacht Group

IYBA
International Yacht Brokers Association

Produced by
INTERNATIONAL YACHT BROKERS ASSOCIATION
1845 Cordova Road, Suite 205, Fort Lauderdale, FL 33316
P | 954-522-9270 F | 954-764-0697 www.fyba.org

KOGOD SCHOOL of BUSINESS
AMERICAN UNIVERSITY • WASHINGTON, DC

U.S. House of Representatives Committee on Ways & Means Tax Policy Subcommittee

Statement for the Record in Connection with July 13th Hearing: "How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs"

Professor Caroline Bruckner, Executive-in-Residence, Accounting and Taxation & Managing Director, Kogod Tax Policy Center, Kogod School of Business, American University.

July 27, 2017

twitter: @carobruckner • cbruck@american.edu • (202) 885-3258

Subcommittee Chairman Roskam, Ranking Member Doggett, Members of the U.S. House of Representatives Committee on Ways and Means Tax Policy Subcommittee (the "Committee") and staff, my name is Caroline Bruckner and I submit the following comments in my capacity as Managing Director of American University's Kogod Tax Policy Center (KTPC), which conducts nonpartisan policy research on tax and compliance issues specific to small businesses and entrepreneurs.

At the KTPC, we applaud the Committee's initiative in soliciting testimony and submissions on how tax reform can work to help small businesses grow and create new jobs. As Congress moves forward with tax reform, this Committee will play an important role in informing Congress on tax and compliance challenges facing small businesses under the current system and developing necessary improvements, however, with respect to women-owned firms, there is significantly more work to be done.

Specifically, our latest research, *Billion Dollar Blind Spot – How the U.S. Tax Code's Small Business Tax Expenditures Impact Women Business Owners*, which we released on June 12, 2017, identifies a number of barriers to business growth that impact women-owned firms, the overwhelming majority of which are small businesses. Moreover, our report assesses how the U.S. tax code's more than $255 billion of tax expenditures targeted to help small businesses grow and access capital effect women-owned firms and makes the following findings.

- While women-owned firms have increased to now total more than 11 million (or 38% of all U.S. firms), the majority of women business owners are small businesses operating in service industries and they continue to have challenges growing their receipts and accessing capital.
- At the same time, three of the four small business tax expenditures we assessed are so limited in design that they either (i) explicitly exclude service firms, and by extension, the majority of women-owned firms; or (ii) could effectively bypass women-owned firms who are not incorporated or who are service firms with few capital-intensive equipment investments altogether. Our survey data of women business owners corroborates these findings, and nevertheless suggests that when women-owned firms can take advantage of tax breaks, they do. However, neither Congress nor Treasury or IRS or SBA has ever measured how the tax code impacts women business owners.
  - For example, we identified only three women business owners who had ever used Internal Revenue Code Section 1202—a $6 billion tax expenditure—to raise capital for their firms. While we expect that more than three women-owned firms have used this provision since 1993, we don't have publicly-available taxpayer data to prove it. This example highlights why we need tax research on women business owners.
- Similarly, our survey found that women business owners use Section 179 at significantly lower rates than existing government research finds for businesses generally. This tax break is one of the most expensive (it will cost $248 billion from 2016-2020), and yet we don't have any research on how it benefits women business owners.

Our findings raise questions as to (i) whether the U.S. tax code's small business tax expenditures are operating as Congress intended for these small businesses; and (ii) whether the cost of these expenditures has been accounted for in terms of their uptake by women-owned firms. In answering these questions impacting millions of women business owners, we found that Congress and stakeholders have a billion-dollar blind spot when it comes to understanding how effective small business tax expenditures are with respect to women-owned firms. Moreover, our research shows that while the tax-writing committees have solicited testimony from women business owners over the years, since at least 1986, neither of the Congressional tax-writing committees has held a full-committee hearing on assessing the impact of the tax code's small business tax expenditures on women business owners. As a result, we have grave concerns that Congress does not have data or research to make evidence-based tax policy decisions with respect to these small businesses.

The time is now for Congress to consider the tax challenges of women business owners who represent more than one-third of all U.S. businesses, but who continue to struggle grow and access capital. As such, we recommend the following strategies for this Committee to employ as part of its work on tax reform including:

1. Holding joint hearings together with the U.S. House of Representatives Committee on Small Business on the small business tax issues identified in our report;
2. Requesting the Joint Committee on Taxation develop estimates on how small business expenditures impact women-owned firms;
3. Requesting the federal Commission on Evidence-Based Policymaking develop strategies for developing the data we need to measure these expenditures in terms of women-business owners; and
4. Requesting the nomination and confirmation of a new Director of the Census Bureau in order to ensure the timely execution of the 2017 Survey of Business Owners.

Congress has demonstrated time and again its commitment to alleviating the tax burdens faced by American businesses generally, and small businesses specifically. So much so, that under current law, taxpayers will forego more than $255 billion from 2016 to 2020 just on the four small business tax expenditures assessed in our report. And yet there has been no formal accounting as to whether and how these expenditures impact or are distributed to or among women-owned firms—99% of which are small businesses, according to SBA's Office of Advocacy's latest report on women-owned firms. Quite simply, Congress doesn't know whether the money it has spent trying to help smaller firms access capital and grow has been well spent with respect to women-owned firms.

The absence of research on these issues is contrary to recent Congressional efforts to engage in evidenced-based policy making going forward and means Congress does not have adequate data to understand the challenges to growth impacting more than 11 million small businesses. This Committee can and should immediately work to develop the needed research to understand the tax barriers facing these small businesses. We stand ready to aid the Committee in this important work on behalf of the millions of small businesses impacted by these issues.

LEE-MOORE
CAPITAL COMPANY

Monday, July 10, 2017

United States House Committee on Ways and Means Tax Policy Subcommittee
1102 Longworth HOB
Washington D.C. 20515
(Delivered via e-mail)

RE: Preservation Of Interest Deductibility in Promoting Pro-Growth Tax Reform

Dear Chairman Roskam, Ranking Member Doggett, and Members of the Subcommittee:

As the owner of Lee-Moore Capital Company, based in North Carolina, I want to share my input as to how I believe Congress can accomplish tax reform that will help businesses like mine create jobs and best contribute to my state and our nation's economic vitality. I applaud the efforts of this committee to make tax reform a top priority, as this reform is imperative to our nation's ability to compete in the 21st Century global marketplace.

Please consider the importance of preserving full interest deductibility on borrowing for all American businesses as you reform the American tax code in a way that will promote long-term growth. If you share my goal of maximizing growth potential, I believe Congress must avoid advancing proposals that limit or eliminate the deductibility of interest.

The deductibility of business interest expense dates back nearly a century, to when our modern tax structure was established. It is a well-established component of the tax code that has been vital to making our nation's economy the strongest in the world. It is a necessary tool to properly measure income. Not maintaining interest deductibility will overstate a business' taxable income resulting in over-taxation of businesses, the last thing you want to do if the goal is more and better job creation. By guaranteeing businesses will not be taxed on the cost of accessing capital, interest deductibility affords business owners like me the correct tax treatment and enables us to focus on how to best invest to create more jobs to keep growing and sustaining our economy.

LMCC is a 3rd Generation family business operating for 80 years, and I can tell you how important it has been to have the ability to deduct interest. We use Interest Deductibility to finance and develop real estate projects that provide significant multiplier economic development impact and tax base increases for my local community.

Amid the unpredictability of the global economy and its impact on our nation's own economy, interest deductibility provides at least some certainty and predictability in managing my business's everyday finances and long-term growth prospects.

That is why I strongly encourage the Senate Finance Committee, as it considers tax reform, to please maintain the full deductibility of business interest expense as it exists under current law. By keeping this important component of the tax code in place, you will help ensure the American economy has the opportunity to achieve its full growth potential. Thank you for your consideration.

Sincerely,

Kirk J. Bradley
Chairman, President & C.E.O.
PO Drawer 9
Sanford, NC 27331
919-895-6001

CC: The Honorable George Holding (R, NC-02)
Member, U.S. House Committee on Ways and Means Tax Policy Subcommittee
1110 Longworth House Office Building
Washington, D.C. 20515

THE LIKE-KIND EXCHANGE STAKEHOLDER COALITION

July 26, 2017

The Honorable Peter Roskam
Chairman
House Committee on Ways and Means
Subcommittee on Tax Policy
2246 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Lloyd Doggett
Ranking Member
House Committee on Ways and Means
Subcommittee on Tax Policy
2307 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Roskam and Ranking Member Doggett:

We are submitting the following statement for the record in response to the House Ways and Means Subcommittee on Tax Policy's hearing on July 13, 2017 entitled *How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs.* As you consider ways to create jobs, grow the economy, and raise wages through tax reform, we strongly urge that current law be retained regarding like-kind exchanges under section 1031 of the Internal Revenue Code ("Code"). We further encourage retention of the current unlimited amount of gain deferral.

Like-kind exchanges are integral to the efficient operation and ongoing vitality of thousands of American businesses, which in turn strengthen the U.S. economy and create jobs. Like-kind exchanges allow taxpayers to exchange their property for more productive like-kind property, to diversify or consolidate holdings, and to transition to meet changing business needs. Specifically, section 1031 provides that taxpayers do not immediately recognize a gain or loss when they exchange assets for "like-kind" property that will be used in their trade or business. They do immediately recognize gain, however, to the extent that cash or other "boot" is received. Importantly, like-kind exchanges are similar to other non-recognition and tax deferral provisions in the Code because they result in no change to the economic position of the taxpayer.

Since 1921, like-kind exchanges have encouraged capital investment in the U.S. by allowing funds to be reinvested back into the enterprise, which is the very reason section 1031 was enacted in the first place. This continuity of investment not only benefits the companies making the like-kind exchanges, but also suppliers, manufacturers, and others facilitating them. Like-kind exchanges ensure both the best use of real estate and a new and used personal property market that significantly benefits start-ups and small businesses. Eliminating like-kind exchanges or restricting their use would have a contraction effect on our economy by increasing the cost of capital, slowing the rate of investment, increasing asset holding periods and reducing transactional activity.

A 2015 macroeconomic analysis by Ernst & Young found that either repeal or limitation of like-kind exchanges could lead to a decline in U.S. GDP of up to $13.1 billion annually.[1] The Ernst &

[1] *Economic Impact of Repealing Like-Kind Exchange Rules,* ERNST & YOUNG (March 2015, Revised November 2015), at (iii), *available at* http://www.1031taxreform.com/wp-content/uploads/Ling-Petrova-Economic-Impact-of-Repealing-or-Limiting-Section-1031-in-Real-Estate.pdf.

Young study quantified the benefit of like-kind exchanges to the U.S. economy by recognizing that the exchange transaction is a catalyst for a broad stream of economic activity involving businesses and service providers that are ancillary to the exchange transaction, such as brokers, appraisers, insurers, lenders, contractors, manufacturers, etc. A 2016 report by the Tax Foundation estimated even greater economic contraction – a loss of 0.10% of GDP, equivalent to $18 billion annually.[2]

Companies in a wide range of industries, business structures, and sizes rely on the like-kind exchange provision of the Code. These businesses—which include real estate, construction, agricultural, transportation, farm / heavy equipment / vehicle rental, leasing and manufacturing—provide essential products and services to U.S. consumers and are an integral part of our economy.

A microeconomic study by researchers at the University of Florida and Syracuse University, focused on commercial real estate, supports that without like-kind exchanges, businesses and entrepreneurs would have less incentive and ability to make real estate and other capital investments.[3] The immediate recognition of a gain upon the disposition of property being replaced would impair cash flow and could make it uneconomical to replace that asset. This study further found that taxpayers engaged in a like-kind exchange make significantly greater investments in replacement property than non-exchanging buyers.

Both studies support that jobs are created through the greater investment, capital expenditures and transactional velocity that are associated with exchange properties. A $1 million limitation of gain deferral per year, as proposed by the Obama Administration[4], would be particularly harmful to the economic stream generated by like-kind exchanges of commercial real estate, agricultural land, and vehicle / equipment leasing. These properties and businesses generate substantial gains due to the size and value of the properties or the volume of depreciated assets that are exchanged. A limitation on deferral would have the same negative impacts as repeal of section 1031 on these larger exchanges. Transfers of large shopping centers, office complexes, multifamily properties or hotel properties generate economic activity and taxable revenue for architects, brokers, leasing agents, contractors, decorators, suppliers, attorneys, accountants, title and property / casualty insurers, marketing agents, appraisers, surveyors, lenders, exchange facilitators and more. Similarly, high volume equipment rental and leasing provides jobs for rental and leasing agents, dealers, manufacturers, after-market outfitters, banks, servicing agents, and provides inventories of affordable used assets for small businesses and taxpayers of modest means. Turnover of assets is key to all of this economic activity.

In summary, there is strong economic rationale, supported by recent analytical research, for the like-kind exchange provision's nearly 100-year existence in the Code. Limitation or repeal of section 1031 would deter and, in many cases, prohibit continued and new real estate and capital

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[2] *Options for Reforming America's Tax Code*, Tax Foundation (June, 2016) at p79, *available at* http://taxfoundation.org/article/options-reforming-americas-tax-code.

[3] David Ling and Milena Petrova, *The Economic Impact of Repealing or Limiting Section 1031 Like-Kind Exchanges in Real Estate* (March 2015, revised June 2015), at 5, *available at* http://www.1031taxreform.com/wp-content/uploads/Ling-Petrova-Economic-Impact-of-Repealing-or-Limiting-Section-1031-in-Real-Estate.pdf.

[4] *General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals*, at 107, *available at* https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf.

investment. These adverse effects on the U.S. economy would likely not be offset by lower tax rates. Finally, like-kind exchanges promote uniformly agreed upon tax reform goals such as economic growth, job creation and increased competitiveness.

Thank you for your consideration of this important matter.

Sincerely,

Air Conditioning Contractors of America
American Car Rental Association
American Rental Association
American Seniors Housing Association
American Truck Dealers
American Trucking Associations
Associated Equipment Distributors
Associated General Contractors of America
Avis Budget Group, Inc.
Building Owners and Managers Association (BOMA) International
C.R. England, Inc.
Equipment Leasing and Finance Association
Federation of Exchange Accommodators
International Council of Shopping Centers
Investment Program Association
NAIOP, the Commercial Real Estate Development Association
National Apartment Association
National Association of Home Builders
National Association of Real Estate Investment Trusts
National Association of REALTORS®
National Automobile Dealers Association
National Business Aviation Association
National Multifamily Housing Council
National Ready Mixed Concrete Association
National Stone, Sand and Gravel Association
Truck Renting and Leasing Association

TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

NFIB
The Voice of Small Business.®

Statement for the Record of Juanita D. Duggan

National Federation of Independent Business

Before the

U.S. House Committee on Ways and Means, Subcommittee on Tax Policy

Hearing on: "How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs"

July 13, 2017

National Federation of Independent Business (NFIB)

1201 F Street, NW Suite 200

Washington, DC 20004

Dear Chairman Roskam and Ranking Member Doggett,

On behalf of the National Federation of Independent Business (NFIB), I appreciate the opportunity to submit a statement for the record to the Ways and Means Subcommittee on Tax Policy's hearing on, "How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs."

NFIB is the nation's leading small business advocacy organization. Founded in 1943 as a nonprofit, nonpartisan organization, our mission is to promote and protect the right of its members to own, operate, and grow their businesses. NFIB represents approximately 325,000 independent business owners located throughout the United States.

Tax reform starts with small business. As such, any reform proposal should include the following priorities:

- Small business rate parity – Small businesses should not face a higher tax rate than large corporations, which would put them at a competitive disadvantage.
- Lower tax rates for all small businesses – No small business should pay a higher tax rate than they do currently, so any business tax rate should be graduated.
- A simpler tax code – Tax reform should result in a tax code that makes it easier for small businesses to comply.

Fortunately, the tax reform plan outlined by President Trump achieves the rate parity goal, as does Ways and Means Committee Member Vern Buchanan's (FL-16) legislation, H.R. 116, the *Main Street Fairness Act.* We remain confident that Congress and the Administration will unite behind a tax reform proposal that starts with small business and achieves these goals.

Since 2012, "taxes" rank as the first or second most important problem small business owners face every month. According to the NFIB Research Foundation's June 2017 *Small Business Economy Trends Survey*, 22 percent of NFIB members identified taxes as the single most important issue facing their businesses.[1] Further, business owners who believe conditions will improve in the next six months fell in June. This drop is due in large part to Congress' inactivity on tax reform.[2]

Additionally, the most important source of financing for small business is their earnings, i.e. cash flow. This explains why cash flow is ranked 13th out of 75 potential business problems in the latest NFIB Research Foundation's *Problems and Priorities Survey*.[3] Because cash flow is closely tied to the tax burden, five of the top ten small business concerns in the *Problems and Priorities Survey* are tax related.[4]

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[1] Holly Wade, *Small Business Economic Trends Survey*, June 2017.
[2] *Id.*
[3] Holly Wade, *Small Business Problems & Priorities,* NFIB Research Foundation, Washington, DC, series, page 13.
[4] *Id.* page 12.

Tax reform has the potential to have an enormously positive impact on small businesses; it is their top priority in 2017. Given that small businesses account for nearly half of the gross domestic product (GDP) and private sector workforce, and create two out of every three net new jobs, the U.S. economy will not reach its full potential for growth without a robust and flourishing small business sector.

America's small business owners and NFIB stand fully prepared to help make tax reform a reality, so long as tax reform starts with small business. This is a historic opportunity to jump-start our economy and sustain it for the long-term. NFIB appreciates the opportunity to provide comments regarding the top issue concerning small businesses – comprehensive tax reform. Tax reform must reduce rates on both pass-through entities and corporations simultaneously. Otherwise, the tax code will simply grow more lopsided and complex. The effect of complexity and the preservation of cash flow are key elements for small businesses as Congress considers comprehensive tax reform.

Thank you for holding this important hearing. We look forward to working with the committee towards the shared goal of comprehensive tax reform.

July 12, 2017

Dear Chairman Roskam, Ranking Member Doggett, and members of the House Ways and Means Tax Policy Subcommittee:

Thank you for holding this very important hearing on tax policy and the impact small businesses has on the growth of the American economy.

NGA is the national trade association representing retail and wholesale grocers that comprise the independent sector of the food distribution industry. An independent retailer is a privately owned or controlled food retail company operating in a variety of formats. Most independent operators are serviced by wholesale distributors, while others may be partially or fully self-distributing. Some independents are publicly traded, but with controlling shares held by the family and others are employee owned. Independents are the true "entrepreneurs" of the grocery industry and are dedicated to their customers, associates, and communities. Much of NGA's membership is comprised of family-owned and family-operated small businesses. Over 60 percent of NGA's members are single-store operators, and an additional 20 percent operate less than five stores. The independent supermarket channel is accountable for close to one percent of the nation's overall economy and is responsible for generating $131 billion in sales, 944,000 jobs, $30 billion in wages, and $27 billion in taxes.

Independent Grocers' Seek Certainty

Certainty in that tax code is paramount to creating and sustaining jobs in an industry that operates on such a slim margin. We ask that as Congress moves forward it considers making lasting, permanent changes to the tax code. The smallest changes in tax policy could alter the profit picture of NGA member companies.

What is not well known about the industry is that it operates on very slim margins. According to the *2017 Independent Grocers Financial Survey*, the average store has a 0.98% profit margin, and the average store has approximately $9,600,000 in annual revenue.

The average NGA member paid an effective tax rate of 33.8%. Lowering the effective tax rate, for example, could have a large effect on after tax cash flows that would lead to more investment and jobs.

Lowering the top marginal income tax rate would have a very powerful stimulative effect on the economy. When profits are at 0.98% of revenues, decisions to spend money to hire or to grow, decisions that would benefit the economy, are often put off. The added after-tax cash flow would allow NGA members to hire additional employees, fund the renovations of stores, or finance a new store. The reduction in income tax rates would jump-start the engine of economic growth for the industry.

Estate Tax
The permanent repeal of the estate tax would ensure that a business does not see disruptions in its economic cycle following the death of an owner. NGA members are typically private- or closely-held companies without access to the public securities markets to raise cash. To meet the obligation of a potential estate tax liability, NGA member companies will either have to sell the business or have to borrow capital. Borrowing will put a strain on a business that has a very narrow profit margin. The debt service of the loan to pay the estate tax takes away capital that could deployed towards a different use that would help the business and the economy grow. As a measure that would help family businesses grow and remain viable, NGA strongly encourages the permanent repeal of the estate tax.

Deductibility of Interest
Altering the interest expense deduction would have a negative impact on the independent supermarket industry. NGA member companies do not generate interest income. NGA members tend to have significant interest expense, whether it is from renovations, additions, purchasing new equipment, or opening the next store. Therefore, the interest expense that is created by borrowing for capital expenditures would be carried forward not be deductible.

At the same time, the House GOP has proposed that the altering of the interest deduction come with 100% expensing. According to the *2017 Independent Grocers Financial Survey*, the average store had $153,000 in capital expenditure costs. Under current law, I.R.C. Sec. 179 allows a company to expense $500,000 per year. The House GOP's proposal would be a negative for independent for grocery industry. Current law provide acceptable regime for the capital expenditures for NGA members.

NGA would not support the move to full expensing at the cost of the loss of the interest expense deduction. Accelerating a timing deduction in exchange for the loss of a permanent deduction is not acceptable to NGA.

Parity of Pass Through Entities
Congress should recognize the diversity of company structures and make tax reform work equally for pass-throughs and C corporations. Tax reform should respect decisions made by business owners on how they choose to organize their business. The decision of how to organize should be made based upon what works best for business in light of their individual circumstances. Congress should not dictate decisions about nor favor one type of business over another. Tax reform must include both pass-throughs (which represent 95% off the business filings in the United States in 2012) and C corporations, and should strive to create parity between the two structures. Both C corporations and pass-throughs deserve a lower effective federal tax rate.

Border Adjustable Tax
Congress should not include a border adjustment tax (BAT) in tax reform. The BAT should not be considered as part of comprehensive tax reform. If a BAT is put in place, American consumers may face significantly higher food prices (possibly as much as 20% higher) for goods that in many cases aren't even produced in the United States (e.g. coffee, bananas). It is not fair

to subsidize exporters by increasing the cost of doing business for food retailers and raising the costs that consumers might pay at the register.

LIFO Accounting

Tax reform should preserve the use of the use of the last-in, first-out (LIFO) method of inventory accounting. LIFO has been allowed since 1939 and is broadly employed in the food wholesale and retail industry. LIFO helps protect against inventory price shocks that can result from inflation and is an important tool that aids industry in long-term planning. Congress should make sure that tax reform proposals allow for the continued use of the valuable tool.

Thank you for considering our comments,

Peter J. Larkin
President and CEO
National Grocers Association

NRF THE VOICE OF RETAIL

July 13, 2017

The Honorable Peter Roskam
Tax Policy Subcommittee of the
House Ways and Means Committee
United States House of Representatives
Washington, DC 20515

The Honorable Lloyd Doggett
Tax Policy Subcommittee of the
House Ways and Means Committee
United States House of Representatives
Washington, DC 20515

Dear Mr. Chairman and Mr. Doggett:

Please add these comments of The National Retail Federation (NRF) to the hearing record for the Tax Policy Subcommittee July 13 hearing on how tax reform will enhance the contribution that small businesses make to the growth of the economy and the creation of jobs for American workers.

Small businesses make up 98% of the retail industry and provide 40% of the industry's 42 million jobs. Our retail members believe that a reform of the income tax, by providing a broad base and low rates, will bring the greatest economic efficiency and simplicity to the federal tax system. These changes will lead to greater investment, more jobs and greater economic growth. In making these reforms, it is important that the tax code not place different tax burdens on taxpayers in similar economic circumstances. For this reason, tax reform must be applicable to all businesses, not just C corporations. A reformed income tax code should not include tax preferences based on the form of legal entity (e.g. C corporations vs. pass-through entities), how property is owned (e.g. leased stores vs. owned stores), or distribution channel for sale of merchandise (e.g. brick and mortar sales vs. remote sales). Our small retail members are also very concerned about tax reform efforts that might shift the burden of taxation to consumption. Increased costs to the consumer will cause sales to decline and result in a contraction in their businesses.

We have surveyed NRF's small retail members with respect to the impact of the House Blueprint for Tax Reform on their businesses. The provision that causes them the greatest concern is the border adjustment tax (BAT). (A summary of their responses to questions about the BAT is here.) Of small business retailers that source merchandise from overseas, 85% say it's important that they do so for their business to succeed. Three out of five small retailers expect a negative business impact if BAT is enacted.

Some retailers said that the only costs they could cut to try to offset the impact of the higher tax from enactment of the BAT was payroll, since all other costs were fixed. If the 9% of retail small business owners that said they would lay off workers reduced their headcount by just 5%, that would result in 215,000 jobs being lost. If the 11 % of retail owners that said they would cut cost by decreasing employee hours cut just two hours of work per week, that would cause about $490 million in lost wages in the first year.

Other respondents believed that the higher product costs would have such a devastating effect on their sales that they would probably be driven out of business. Eighteen percent of small retailers say a border adjustment tax on all items they source from overseas would threaten their business or cause it to fail. The estimated employee loss of these retail small businesses going under is 772,000 jobs.

Our small retailers were also greatly concerned about the loss of the interest deduction. All of our small businesses raise capital for inventory purchases or remodeling expenses through loans. The Blueprint's provision allowing for expensing of capital assets does not offset the loss of the interest deduction for small retailers, as their capital expenditures are sporadic.

We appreciate the opportunity to continue to work with the Committee on pro-growth tax reform. Small retailers are probably the business group that is hardest hit by the potential impact of the BAT, as they do not have the economies of scale to be able to reduce the higher costs of their merchandise with the BAT imposed and are most likely to lose sales to lower-priced competition. We hope to work with you towards an alternative to the BAT and protect small retailers and the almost 17 million jobs that they contribute to the U.S. economy.

Sincerely,

David French
Senior Vice President
Government Relations

cc: Ways and Means Subcommittee on Tax Policy

Border Adjustment Tax and Retail Small Business

For today's retail businesses, sourcing quality materials, finished goods and services from overseas markets is essential – especially for small businesses to thrive. In fact, **of small business owners who source such materials from overseas, 85 percent say doing so is important for their businesses to succeed.**[1]

If Congress were to pass a border adjustment tax that implements a 20 percent tax on all imports as proposed, most retail small business owners surveyed say they would need to make some drastic changes. **Regardless of party affiliation, at least three out of every five small retailers anticipate a negative business impact should a BAT be enacted.**

Ninety-eight percent of the 651,000 retail businesses in the United States have fewer than 100 employees. These small businesses form the backbone of many communities. Unfortunately, **9 percent of retail small business owners indicated that if the BAT were enacted, they would have to lay off workers.** When the scale of retail small business is considered, this would have a profound impact. **If those businesses reduced their head count by just 5 percent, 215,000 jobs would be lost.**

- 215,000 jobs is four times the total number of people employed by the coal mining industry
- That is more jobs than the entire newspaper publishing industry
- Those workers could form an unemployment line stretching the length of the entire Washington Beltway

Eleven percent of those retail business owners would have to cut costs by decreasing employee hours. If each affected worker lost just two hours of work per week, that would cause about $490 million[2] in lost wages in the first year.

Small business shoppers' wallets will also see the effect of a BAT: **A third (34 percent) of retail small businesses would need to raise prices.** When running a business with the kind of tight profit margins that retailers see, every penny counts. **Eighty-six percent of small retailers cite the importance of sourcing cost effective materials from overseas to the success of their business.**[3]

The BAT would be more than just a cost increase on needed materials and products: It would threaten the existence of small retailers across the country. Eighteen percent of small retailers say a border adjustment tax on all items they source from overseas would threaten their business or cause it to fail. The estimated employee loss of these retail small businesses going under: 772,000 jobs. [4]

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[1] Asked of those who source any materials, finished goods, and services for their business from overseas.
[2] 11% of retail employees at retail companies with fewer than 100 employees, assuming a $10/hour wage
[3] Asked of those who source any materials, finished goods, and services for their business from overseas.
[4] NRF calculations based on U.S. Census Bureau, Statistics of U.S. Businesses dataset

National Roofing Contractors Association

Statement for the July 13, 2017 Hearing Record
"How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs"
House Committee on Ways and Means
Subcommittee on Tax Policy

Introduction

The National Roofing Contractors Association (NRCA) commends Chairman Roskam, Ranking Member Doggett and members of the Committee for your commitment to reform the nation's tax code. NRCA is grateful for the opportunity to share our recommendations with committee members on how the tax code can work better for roofing industry employers. NRCA supports pro-growth policies that enable entrepreneurs to invest in and grow their businesses, which will in turn create more high-paying roofing industry jobs.

Established in 1886, NRCA is one of the nation's oldest trade associations and the voice of professional roofing contractors worldwide. NRCA's 3,600 member companies represent all segments of the roofing industry, including contractors, manufacturers, distributors, consultants and other industry employers in all 50 states. NRCA members are typically small, privately held companies, but our membership includes businesses of all sizes. During peak season, the average member employs 45 people.

As the committee looks to overhaul the nation's tax code, we ask that you address the following key issues of importance to the roofing industry.

Lower Tax Rates

NRCA supports tax reform that lowers rates for all types of businesses and opposes any legislation that increases taxes on businesses in the roofing industry. We were pleased to see lowered tax rates as part of the 2016 "A Better Way for Tax Reform" Blueprint. Today, many roofing industry entrepreneurs face federal tax rates as high as 39.6 percent on income that is often the only source of capital for reinvesting in their business. These job creators have also been impacted in recent years by effective tax increases such as the phasing out of personal exemptions, limiting itemized deductions, and the increase in capital gains and dividends rates in 2013. Additionally, many business owners now face the 3.8 percent Medicare tax authorized by the Affordable Care Act.

Each employer must choose the best structure for their business, whether it is an S-corporation, LLC, partnership, sole proprietorship or C-corporation. An estimated 75 percent of NRCA members are organized as pass-through entities that pay their business income tax at the individual level and 25 percent of our members are C-corporations. NRCA contractor members range in size from companies with less than $1 million in annual sales volumes (54 percent of the current membership) to large, commercial contractors with annual sales volumes of more than $20 million (1 percent of the current membership). NRCA also represents manufacturers, distributors and other roofing industry employers that have a wide array of business structures.

Given NRCA's diverse membership, it is imperative that tax reform be comprehensive, lowering both the corporate and individual tax rates. A study conducted by Ernst & Young found that pursuing so-called "corporate-only" tax reform, in which only the tax rate for C-corporations is lowered, would increase the income taxes paid by individual owners of flow-through construction businesses, on average, by 9 percent or $26 billion annually.[1] There is already a large disparity between the top corporate and individual tax rates. Increasing this disparity would encourage businesses to try and circumvent the higher rates, ultimately resulting in wasted resources and lower growth.

NRCA supports tax reform that contains lower rates for all types of businesses and applauds the intention of the 2016 Blueprint to expand upon the concepts created by Rep. Vern Buchanan's Main Street Fairness Act (H.R. 5076). This will provide greater incentives for employers to reinvest in their business, thus boosting economic growth and creating high-paying jobs within the roofing industry and broader economy. NRCA looks forward to working with the Committee on Ways and Means to achieve this objective which is critical to getting the U.S. economy fully back on track.

Business Investment Incentives

NRCA believes that truly comprehensive tax reform should include reforming key parts of the tax code to help businesses more quickly recover the cost of investments in property, equipment and inventory. By freeing up invested capital, these reforms will foster new business formation and help existing businesses of all sizes expand operations, create new jobs and fuel greater economic growth.

NRCA strongly supports provisions in the 2016 Blueprint that are designed to increase incentives for business investment by reforming the outdated expensing and cost recovery rules in the tax code. Allowing full and immediate expensing of a broad range of property and equipment, including commercial roofs and other building components, is crucial to job creators in the roofing industry.

NRCA commends Reps. Tom Reed and Bill Pascrell for their leadership on bipartisan legislation, entitled the Roofing Efficiency Jobs Act (H.R. 4740 in the 113th Congress), to create more jobs in the roofing industry by addressing the outdated cost recovery rules for commercial roofs. NRCA supports the expensing provisions contained the 2016 Blueprint because this proposal will accomplish NRCA's long-standing goal of reforming the outdated depreciation schedule for commercial roofs. Reform of the outdated cost recovery schedule for commercial

[1] Robert Carroll and Gerald Prante, "The Flow-Through Business Sector and Tax Reform," April 2011.

roofs, which restricts economic growth in our industry, would facilitate the creation of an estimated 40,000 new private sector jobs among roofing contractors and manufacturers.[2]

Depreciation reform for commercial roofs is crucial because between 1981 and 1993 the depreciation schedule for nonresidential real property was increased from 15 years to 39 years. However, the current 39-year depreciation schedule is not a realistic measure of the average life span of a commercial roof. A study by Ducker Worldwide, a leading industrial research firm, determined the average life expectancy of a commercial roof to be 17 years.[3]

The large disparity between the current 39-year depreciation schedule and the actual 17-year average life span of a commercial roof is a major obstacle that prevents building owners from replacing failing roofs in a timely manner. This slows economic activity because an owner who replaces a roof before the 39 years have elapsed in most cases must continue to depreciate that roof for tax purposes even though it no longer exists. A Treasury Department Report corroborated this problem, finding "…a 'cascading' effect, where several roofs are being depreciated at the same time, even though only one is physically present."[4] Given this situation, many building owners choose to do only piecemeal repairs rather than replace a failing roof in its entirety.

Providing for full expensing of commercial roofs, as contained in the House 2016 Blueprint, will finally achieve reform of the cost recovery rules for commercial roofs that will increase economic activity and create high paying jobs in the roofing industry. It will also provide additional economic benefits by reducing energy costs for businesses that install new roofs. Because of technological advances within the industry, today's commercial roofs are more energy-efficient than their predecessors. Removing the outdated depreciation schedule that inhibits building owners from performing full roof retrofits in a timely manner will not only create new jobs in our industry, but will reduce energy costs and consumption within the commercial building sector.

Cost recovery reform for commercial roofs enjoys the support of a broad array of constituencies, including business, manufacturer, labor union and other organizations. By simplifying the out-dated cost recovery rules for commercial roofs to the investment expensing provisions, as contained in the 2016 Blueprint, tax reform will accelerate economic growth and create more jobs in the roofing industry. As such, NRCA urges the inclusion of these provisions in tax reform legislation considered by the Ways and Means Committee in 2017.

Estate Tax

Many NRCA member businesses are closely held family operations, passed on from generation to generation. Much of the value of family-owned businesses, especially those in the construction industry, is tied to illiquid assets such as land, buildings and equipment. As such, new owners are often forced to sell these assets or the business itself to pay the tax due when

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[2] Ducker Worldwide, "Comprehensive Nonresidential Building Analysis to Estimate the Current Reality of Roofing Longevity," September 2003.
[3] Ducker Worldwide.
[4] US Department of Treasury, "Depreciation Recovery Periods and Methods," July 2000

entrepreneurs transfer their business to their heirs. This financial burden can be crippling to the viability of the family business. Protecting these job creators from the estate tax is important to keep them operating for future generations. To this end, NRCA was encouraged to see the estate tax repeal in the 2016 Blueprint. Alleviating the burden placed on family-owned businesses is paramount and Congress should permanently repeal the estate tax in any truly comprehensive tax reform legislation.

Conclusion

NRCA looks forward to working with the Committee on Ways and Means towards enacting tax reform that will generate greater economic growth within the roofing industry by addressing the issues discussed above. If you have questions or need more information regarding any of these matters, please contact Duane Musser or Teri Dorn at 202-546-7584.

Thank you for your consideration of NRCA's views.

National Small Business Network

Statement for the Record
House Ways and Means Committee
Tax Policy Subcommittee
Hearing 07-13-2017
How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs

With our limited national economic resources, it is vital that we use the tax reform process carefully to stimulate broad, sustainable, economic growth, and not just borrow against future generations by increasing our national debt to provide a short-term stimulus. The following tax reform recommendations are suggested as part of a balanced program of both tax policy and budget policy actions to restore a sustainable Federal fiscal process. The detailed recommendations build on many of the concepts developed by prior House and Senate committees and working groups and other tax reform advisory groups. They focus primarily on business tax reform issues, particularly for small and mid-sized businesses, because those will have the greatest impact on job creation and general economic growth.

To support sustainable economic growth through tax reform, Congress and the Administration should:

- **Carefully evaluate every major tax change proposal to fully understand and prevent negative secondary economic impacts before enactment.**

- **Simplify and coordinate our overly complex tax code to reduce both taxpayer and IRS administrative expense, and improve compliance.**

- **Make sure that business tax reform provides equitable tax incentives for the growth of small businesses that provide over half of all jobs. These are predominantly pass-through entities which will require separation and equitable treatment of their business income in the personal tax code.**

- **Promote real and sustainable economic growth by providing tax preferences primarily for direct investment in businesses, buildings, and equipment that create new jobs.**

- **Promote long-term investment in new business formation and real property development by correcting the capital gains tax code for long-term inflationary distortions of real gain, and providing better incentives for small business startups.**

- **Promote domestic investment and job creation to the greatest extent possible within the limitations of international agreements by focusing tax preferences on domestic investment and evaluating alternative tax systems to increase international tax equitability, and reduce the ability of multi-national corporations to avoid taxes by shifting profits to lower tax rate countries.**

- **Provide long-term, user based, revenue sources to maintain and improve America's public infrastructure, which is vital to our economic growth.**

- **Assure that any tax reform is at least revenue neutral and provides adequate overall revenue to gradually reduce our national debt and restore long-term fiscal stability**.

Unfortunately, even with short term economic stimulus effects, tax reform will need also to be revenue positive overall to reduce the national debt and unfunded future obligations that were authorized, by prior Congresses. This year's GAO Report to Congress on the Nation's Fiscal Health (GAO 17-237SP) concludes "The federal government is on an unsustainable fiscal path" with spending exceeding revenue by $587 billion in 2016, and the projected debt growing to 100% of total GDP in 15 years. Most economists believe that continuing deficits and our growing $18 Trillion national debt will reduce long-term economic growth, and are a very real threat to the future sustainability of our economy. We support the GAO recommendations for re-establishing fiscal sustainability.

Background:

Our overall tax level is not the cause of our current economic and under employment problems. The total US average Federal, State, and local tax burden is the forth lowest of all 34 OECD countries at 25.7% of GDP. Only Korea, Chile, and Mexico have lower average rates, and the average of all other OECD countries is 34.1% of GDP. With the exception of payroll taxes, most American businesses pay Federal taxes only when they are profitable. The current federal tax level on individuals and "pass-through" business entities is lower than it was during times of economic prosperity and growth, and is lower than most other leading industrial nations. The stated tax rate on large corporations appears higher than other nations, but when adjusted for US business tax incentives and other taxes imposed by foreign countries, such as value added taxes, it is similar to other leading industrial nations. Even during a time of high corporation earnings, corporation income tax revenues have fallen from 5% of gross domestic product in 1952 to only about 1.9% today. Some of this reduction results from smaller corporations converting to subchapter S corporations and LLCs whose income is reported as personal income. Some of it also results from larger corporations avoiding taxes by shifting taxable income to foreign countries with lower tax rates on net income.

For the past 10 years, most Federal tax rates have been lower than historical averages, particularly on the very wealthy who are receiving an increasing percentage of all income and assets. This is a major cause of our spiraling debt. Lower tax rates, particularly on capital gains and stock dividends have also encouraged financial speculation which was a major cause of the 2008 recession. However, as the last 10 years have proven, lower tax rates did not promote sustainable domestic economic growth.

Key Issue Areas:

1. Avoid Tax Changes with Negative Secondary Economic Consequences.

When looking for ways to raise tax revenue, it is easy to jump at ideas that may appear to generate income, without understanding the negative secondary impacts on the economy and employment. The proposal for a "Border Adjusted Cash Flow Tax" (BACFT) was promoted as a way to increase revenue and "prevent jobs from moving overseas", but if it is adopted it would do exactly the opposite, and should be opposed.

The proposal, which would prevent US resellers from deducting their cost-of-goods-sold on foreign products or components, is unworkable and could devastate the US retail economy. The change would essentially add a new cost burden on all US tax nexus businesses, at their marginal federal and state income tax rate on all items they import for resale. Smaller US retailers who sell foreign produced goods, but do not directly import them, would also face significantly higher costs from their distributors who would have to pass along the high tax penalty cost. Many US manufacturers use imported components and raw materials, and would also have some cost impact and a competitive disadvantage against foreign manufacturers.

Because US end user consumers and non-business organizations cannot deduct the cost of consumption purchases anyway, they can all easily avoid this extra cost impact by simply purchasing directly from a non-US tax nexus internet seller in Canada, Mexico, Europe or Asia. Foreign sellers would probably also not collect the typical 3% - 9% state sales taxes, which even many US internet sellers regularly evade because of a lack of Federal legislation to help states collect use taxes. As a result, a BACFT would create a permanent 25% to 45% cost disadvantage against foreign direct sellers that US retailers and distributors could never overcome. Because of the high percentage of foreign produced goods sold in the US, this would quickly put many US retailers out of business. It would also cause a loss of tens of millions of US retail and distribution jobs, and the loss of trillions of dollars in tax revenue. All the necessary internet sales technologies and direct to consumer distribution systems, for both small and large items, already exist for foreign sellers to use. Exhibit 1 compares the probable average minimum sustainable selling price to US consumers, if the House proposal was enacted, for large physical store and internet retailers, smaller US retailers who purchase from wholesale distributors, and foreign direct shipping retailers, assuming average financial ratios.

Exhibit 1	US Direct Import Retailer	US Indirect Retailer	Canada based Internet Direct Retailer
Actual landed cost of goods to Distribution Center	$1000	$1000	$1000
Added tax cost of BAT at 25% tax rate	$250	$250	
Wholesale distributor markup at 7%		$87	
Freight to retail store at 8% of actual cost	$80	$80	
Total cost of goods sold including BAT tax impact	$1330	$1417	$1000
Min. Sustainable retail price – Physical store at 45% GM	$2420	$2580	
Min. Sustainable retail price – Internet sales at 35% GM	$2040		$1560
6.5% avg. State sales tax	$133	$167	
Total min. sustainable physical store price to a US consumer (45% GM). or	$2553	$2747	
Total min. sustainable US internet seller with state sales tax nexus price to US consumer (35%GM).	$2173		

The potential to get a 39% lower price from a foreign direct seller than from a US physical store retailer would dramatically change consumer shopping patterns. US retail sales of non-perishable foreign goods would drop dramatically along with employment levels and federal and state tax revenues. Large US sellers of imported goods would probably close and re-incorporate in Canada to eliminate US tax nexus, but most smaller retailers would simply go out of business. Any attempt to add a border tariff or customs charge on imports would quickly result in WTO action and retaliatory tariffs on all US exports, hurting US manufacturing. Because it would be a dramatically different tax system, used nowhere else in the world, a BACFT would also place major new regulatory and enforcement burdens on the IRS and major new administrative disruptions and cost burdens on businesses.

Formulary allocation of multinational business profits, as detailed in Section 6 below, is a much simpler and less economically disruptive solution to stimulate US exports and solve the problem of tax avoidance caused by profit shifting, corporate inversions, and tax deferral. FA is a well-established method that most states use to allocate state income tax obligations for both national and international corporations and also how foreign based businesses with US nexus determine their US income tax.

Other provisions of the House “Blueprint” tax reform proposals would also have potential negative consequences for the economy. Immediate expensing of capital investments, even including real property development, sounds tempting for short term economic stimulation, and it probably would cause some immediate activity. But, businesses can only benefit long-term from investment in assets they truly need, even if the investment provides a reduction in current year taxable profits. In future years there will be no depreciation expense to reduce taxable income and they may face dramatically higher taxes, which they may not have budgeted reserves to pay. This may potentially result in business decline or failure. By allowing immediate expensing the Congress would also remove their ability to provide economic stimulus during the next recession, with potentially disastrous consequences. It would also result in a significant reduction in short-term business tax revenue since these businesses would essentially be borrowing part of the cost of the investment from the Federal government. This would further add to the already rapidly growing and un-sustainably high Federal deficit.

The proposed elimination of the deductibility of interest on business borrowing, as a revenue raiser, could also have negative economic impacts. This is particularly important for the development and growth of small businesses who can’t generally issue equity to get capital, and generally pay the highest interest rates. If deductibility of interest is limited for large corporations, interest deductibility should still be allowed for small businesses with a net sale under $10M who depend on borrowing for growth capital

2. Tax Expenditure Recommendations

Tax deductions and special tax rates for different types of income are government expenditures, just like direct budget appropriations. All tax expenditures and special tax rate provisions should be evaluated for their true effectiveness at least every 10 years. Pass permanent or multi-year targeted tax incentives such as business deductions, credits, and accelerated write-offs only where they have been 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 so they actually effect decisions, 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, or emergency stimulus during recessions. 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” limit the ability of Congress to provide strategic incentives for long-term economic sustainability and international competitiveness. Flat tax structures tend to encourage short-term speculation instead of long-term direct investment. They also encourage movement of investment capital anywhere in the world where the potential return is highest. Reducing most current tax expenditures in order to reduce maximum tax rates would probably also 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 social policy affect with the least loss of tax revenue, and often have the greatest incentive effect and benefit for middle income taxpayers

Existing Congressional data does not provide adequate decision-making data 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 current comprehensive analysis of the actual economic benefits of all tax expenditures.

3. Tax Simplicity, Clarity, Equitability, and Efficiency 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. Other provisions have become outdated by changes in technology or business practices.

A. Increase the role of the Joint Committee on Taxation, Treasury Tax Policy and the IRS in assisting Members of Congress in the ongoing development of a simpler and better-coordinated federal tax code. Complexity makes it difficult for taxpayers, and even professional tax preparers, to understand and comply with the code. Complexity also increases the administrative burden on the IRS and makes it difficult for them to provide good taxpayer assistance and improve 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. The Congress should direct JCT, Treasury and the IRS to 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. Continue to revitalize the management and business systems 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 assistance, inadequate IRS budgets, and reduced IRS training and staff levels will eventually threaten accurate and equitable enforcement of tax laws. If this happens, it will also reduce collection of the revenue needed for all other Federal programs and services.

Congress and the Administration need to recommit to the goals of the 1998 IRS Reform and Reorganization effort by providing better taxpayer assistance, support for improvements to technology systems, and stronger management emphasis on business process re-engineering for 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, the IRS needs increased Congressional budget support and better proactive communication on agency issues. The Administration and the Senate also need to complete the 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 and 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 all 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 incomes under $250,000 and replace all surtaxes and deduction phase-outs with a single, more progressive, tax rate structure on personal 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."

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 significant provisions in the regular tax code with the AMT provisions. The tax code should also provide better equality in the AMT treatment of "Small Business Operating Income" reported on a personal Form 1040 return, with the far higher $5M "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

F. Simplify <u>state</u> <u>income tax</u> nexus issues for out-of-state businesses by adopting a modernized federal limitation on non-nexus state income and business activity taxation, of both services and products. This should include digital products delivered from outside a state via public carriers and 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 income often subjects small businesses to significantly higher accounting and tax preparation expenses, and a higher total tax liability

G. Pass marketplace equitability legislation to protect each state's right to use sales and consumption taxes at the state level, and simplify retailer remittance of interstate consumption taxes.
Congress should support effective and efficient interstate, and international, collection of state sales and use taxes. Market Place Fairness legislation would provide an equitable business environment for those businesses that properly collect state sales taxes. A federal interstate sales tax administration legislation would not create any new taxes, but would simply enable states that have chosen to use consumption-based taxes to efficiently collect them on the growing volume of internet purchases. 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. Congress should simplify calculation and reporting of sales taxes for interstate sellers by enabling a single, uniform electronic tax reporting and payment processing system. Because an increasing volume of internet consumer sales are originating from outside the US, the Congress should also consider international agreements and other actions that can help states collect use taxes on foreign direct sales.

4. Capital Gains Tax Reform Recommendations:

Congress should encourage long-term capital investment by adjusting the calculation of long-term capital gain on assets held more than 5 years to remove taxation of the phantom gain from monetary inflation, to properly 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 more than 365 days. This actually progressively penalizes longer-term investments that are held more than one year because of the failure to adjust for monetary inflation over the investment life. The investments that America needs to build a sustainable economy by starting or growing businesses, and building business infrastructure, are not 366-day investments. True long-term business investments may not provide a capital return for 10, 20, 30, or 40 years or longer. Even owners of relatively small businesses will generally be in the maximum rate bracket in the year they sell their business or business property resulting in taxation at the maximum rate. Most states also add an additional state tax of up to 10% on capital gains, based on the federal calculation.

The current law also provides the same tax treatment for individuals who invest in speculative secondary market investments such as traded stocks. Except for new offerings, traded stock purchases create 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 encourages the owners to focus on short-term "paper" profitability and the potential for resale, rather than long-term growth and sustainability. The 366-day incentive peak 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 artificial effect of inflation. Although compensating for some 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, post 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 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.**

<u>The Federal taxes alone would actually exceed the total real economic gain after only about 35 years</u> at a 28% tax rate. State Capital Gains Taxes, which are usually based on the federal calculation, can add up to 10% additional tax on the inflationary increase. 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 participant. Potential revenue offsets for an inflation adjustment include increasing the "long-term" capital gains holding period to 2 or 3 years, or slightly increasing the capital gains tax rates.

5. Small Business "Pass Through" Entity Tax Reform Recommendations:

A. We support a more integrated tax code for all business income. As a first step, Congress should differentiate in the personal income tax code the net "pass-through business income" from a business, in which the taxpayer materially participates, as "Small Business Operating Income" (SBOI). This would include income from sole proprietorships, partnerships, farms, non-salary income from "S" corporations, 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. Most smaller businesses 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 a 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.

In 2011, Congress raised effective tax rates on higher income individuals, many of whom are small business owners with the 3.8% Medicare surtax. Proposed reductions in the large corporation tax rate to 28% or less could potentially shift an even greater percentage of the tax burden onto small businesses and individuals. This will have a significant impact on small and midsize businesses that report their business operating income on the owner's personal return, in addition to the owner's 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 be reinvested in the business for survival and growth. This leaves 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 higher personal tax rates.

Income resulting from direct business investment and active operation of a business that employs people 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. To provide an incentive for small business economic growth and job creation, Congress should set 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 small 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. Although the IRS currently has "reasonable compensation" rules to prevent shifting of personal service or salary income into pass-through entity income further regulatory clarification may be need to prevent abuse and provide clear guidance for businesses.

The Personal Alternative Minimum Tax must also be adjusted for pass-through Small Business Operating Income because it is much different from 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 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. Provide better tax incentives to help small business startups survive and grow.

More than half of small businesses startups fail within the first few years, and tax policy can be a major factor in their ability to survive and grow. 1) The Congress should allow faster deduction of up to $25,000 of initial organization and startup expenses that now must be amortized over 15 years. Some types of small businesses are required by law to be C corporations and almost all technology startups organize as standard corporations. The current rate brackets for small C corporations are unrealistic and should be broadened and lowered in rate to encourage business growth. The marginal tax rates step up quickly from 15% to 34% at only $75,000. Over $10M income is taxed at a 35% flat rate. These excessive rates on small corporations can be a major factor in early business failures.

D. 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.
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 corporations 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.

E. Provide equitable employee cafeteria benefit options for small business owners.
Small businesses compete for workers with large businesses and the public sector. Because of differing family situations, differences in benefit options available through other family members, or because of personal preferences, many employees often want different benefits than fellow 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 limitations discourage small businesses from offering employees a very logical form of employment benefit and make small businesses less attractive for prospective employees.

F. Modernize and simplify the qualified home office deduction to allow de minimus personal use and the conduct of business with clients using electronic technology.
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.

In 2012, the IRS provided a regulatory standard for a simplified home office calculation with a maximum deduction of $1500, but could not address some the basic statutory limitations of the existing code without Congressional action. 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. This is a much higher standard than required of regular business or governmental offices The code also requires the office to be "used by patients, clients, or customers". This language in the code has been interpreted by the IRS to require clients or customers to be physically present in the home office. Today, many businesses do business with their customers without any physical presence. It is both unrealistic and unreasonable not to also allow some de minimus personal activity in an otherwise qualified home office area and to allow the use of digital business practices. Congress should make these changes by statute.

G. Modernize the unrealistic "Luxury" automobile depreciation limitation for business use. 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, without bonus depreciation, during the standard 6-year recovery period with 100% business use. That amount should be periodically adjusted for average vehicle costs.
In 1984 Congress limited the ability to expense or depreciate what they thought were "luxury" automobiles 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 can only fully recover the cost of a $16,935 vehicle which would be inappropriate for many business uses.

H. 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 that are tax deductible. Small businesses, particularly home-based businesses, may have only their kitchen table. They often have to use restaurants as an opportunity to prospect for business and to complete transactions with clients. Other existing code provisions can properly limit excessive meal or entertainment expenditures.

I. Simplify the matching of third party payment reporting on Form 1099 K by correcting the law to require NET income reporting.
Congress made a technical error in the legislation *requiring* third party payment processors to report annual proceeds as an enforcement provision on a gross basis. The IRS has tried to work around this flaw in the legislation by building average estimates of what percentage of net income might result from gross transactions, but many businesses are not “average”, and it is resulting in too many “false positive” examinations.

J. 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, 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

5. International Corporate Tax Policy Recommendations:

Congress should change the taxation of domestic multi-national businesses to a formulary allocation system based on their percentage of sales in the US, to remove the incentive for profit shifting to lower tax countries and corporate inversions. This would put them on the same tax allocation basis as foreign owned multinational businesses with US taxable income and remove the US income tax cost burden on exported goods. As part of the change Congress should also remove the provision to defer taxation of foreign profits until repatriated, currently estimated at $2.4T, and tax all current deferred profits over a five-year period.

The tax code taxes the income from offshore investments of US individuals on the same basis as if the income was received domestically, less the credit for the foreign income taxes paid. The code also taxes domestic businesses with subsidiaries on the basis of their total combined income. The current tax system does not tax earnings of foreign subsidiaries as US income until they are transferred back to the parent corporation. It also allows multinational corporations, particularly those with high intellectual property values, to use inter-division accounting manipulations to shift taxable profits to divisions in lower tax countries where the earnings can multiply. This not only reduces US tax income, but also creates a tax incentive barrier to recognizing and re-investing those earnings in the US for domestic business growth. When intellectual property is developed with US Research and Development tax credits and protected and given value by the US Patent system, the profits from that research should be taxable in the US.

The US should continue to tax the profit of US Corporations from all their controlled foreign business subsidiaries and other investments on the world-wide” basis. The worldwide taxable profit should then be apportioned on the basis of the percentage of final sales or a combination of sales, assets, and employment in the US. There should be no reduced tax rate on repatriated profits because a lower rate would provide no new economic incentives, since the profits are from prior year’s sales. Repatriation will probably also not result in any major US economic benefit from new domestic corporate investment based on economist analysis. Analysis of the last voluntary repatriation incentive found the funds were primarily used for increased dividends and stock buy-backs. The tax rate on repatriated profits does not affect current business competitiveness and businesses have already applied the credits for foreign taxes paid against other income. This deferred tax is owed, and forced recognition and taxation of the $2 Trillion + in deferred off-shore profits would add significant tax revenue to reduce the deficit, or provide alternate tax relief.

Allocating taxation of profits based on the location of sales or other factors has long been used to allocate profits of national businesses between the states. Currently 21 states use a single sales factor for allocating taxable profit and 17 states use a double weight sales or other factors allocation formula. It is also a logical way, with careful limitations and interaction with other countries, to allocate taxable profits internationally. Taxing on the basis of national sales would remove the incentive for profit shifting by multi-nationals. It would also discourage the game of countries bidding down their tax rates to attract tax shifting and allow them to increase revenue for their countries.

Formulary Allocation (FA) would be the simplest of "border adjustable" options, with few transition or regulation issues, and no negative impacts on domestic businesses. It would utilize the existing corporate tax code and international accounting standards, up to the final step of per country allocation. MNBs, with US tax nexus would calculate taxable income on a worldwide basis, but only pay US income tax based on their percentage of sales, or other economic impact factors, in the US. FA meets the stated bi-partisan Congressional objectives for international tax reform, including removal of US income tax cost on American exports.

FA would make it easier for corporations to correctly calculate their US taxes, and for the IRS to accurately audit them since it would more closely match the unified reports MNBs produce for financial reporting purposes. The US states, and political subdivisions in some other countries, have used a sales factor, or multi factor allocation system including sales, employment, and assets, for many years. Most multi-national corporations with US state nexus already report their state income tax liability on that basis. The US already taxes multinationals on a worldwide basis, except for foreign headquartered corporations, who are treated on an activity nexus basis very similar to the way they would be treated under a formulary allocation system. Although there is some potential for misrepresenting sales destinations, the rules used by the states should provide a good basis for accuracy.

FA removes the incentive for profit shifting" to lower tax countries by dividing total world-wide profit to be taxed based on a fairly clearly definable percentage of sales, or other factors, by country. Businesses would not want to reduce sales in the US, regardless of the tax rate. FA also removes the incentive for corporate inversions by taxing both domestic and foreign corporations that have US tax nexus, on the same percentage of sales basis which should meet WTO standards for equal treatment.

FA removes the need for the US, and also for other nations, to try to "bid down" their corporation tax rates to undercut other countries and encourage profit shifting and asset relocation in their direction. If FA was adopted by other countries, it would also allow them to return their tax rates on MNBs to higher levels without losing revenue due to profit shifting.

FA would not be a "New Tax" that could be blamed on either political party. And FA is inherently border "adjusted". It would remove some or all of the US federal income tax cost from goods sold outside the US, making them more competitive. FA would also not disrupt most state corporate income tax systems, which are generally based on the current federal corporation code with formula allocation of unitary profits just as the federal tax would be.

FA could also solves the problem of “trapped" profits and lost tax revenue from deferral of off-shore profits if combined with elimination of deferral and forced recognition of prior year foreign subsidiary profits over a 5-year period. FA would give US multinational businesses permanent tax relief on export sales, rather than locking in permanent tax avoidance from MNB profit shifting if we change to a territorial system. The tax savings for exporting corporations provides a good offset for ending deferral of taxes on prior profits.

FA would restore tax equability to all the domestic corporations and pass-through businesses who have no international tax avoidance or deferral options, and have had to pay a higher share of business taxes over the last 25 years, as MNBs have avoided taxes through profit shifting.

FA could also increase overall US corporation tax revenue, based on historical data, while reducing tax avoidance and broadening the tax base, without creating a disincentive for US investment due to comparative tax rates. JCT should be asked to do an analysis using the most current and projected data, but FA would appear to be revenue positive. The increased tax revenue could be used to reduce the tax rate, or pay down the deficit.

Ohio Corn&Wheat Growers Association
59 Greif Parkway, Suite 101 Delaware, OH 43015
740.201.8088 www.ohiocornandwheat.org

July 13, 2017

The Honorable Peter Roskam
Chairman, House Ways and Means Tax Policy Subcommittee
United States House
2246 Rayburn House Office Building
Washington, D.C. 20510

RE: Preservation of Interest Deductibility in Promoting Pro-Growth Tax Reform

Dear Chairman Roskam and Members of the House Ways and Means Tax Policy Subcommittee,

On behalf of the Ohio Corn & Wheat Growers Associations, we want to share with you our thoughts as to how Congress can achieve tax reform that will help ensure Ohio's corn and wheat farmers can continue to contribute to the growth and strength of our nation's economy. We commend this committee for prioritizing tax reform, and I strongly support your efforts to simplify the U.S. tax code in a way that will help sustain our nation's economic growth within the competitive global marketplace.

In considering the various proposals for reforming our complex tax code in a way that will promote long-term growth, we want to stress to you the importance of preserving full interest deductibility on borrowing for all American businesses, including Ohio's many corn and wheat family farmers. To ensure maximum growth potential, Congress must avoid advancing proposals that seek to limit or completely eliminate the deductibility of interest.

The deductibility of business interest expense, a key component to promoting economic growth, has been part of our modern tax structure for the family farm for nearly a century. By guaranteeing businesses will not be taxed on the cost of accessing capital, interest deductibility affords family farmers the correct tax treatment and enables them to concentrate on investing into their farms in order to keep growing and sustaining our economy.

This is very important when it comes to Ohio corn and wheat farming. It's no secret that agriculture production is capital intensive. Some pieces of farming equipment cost hundreds of thousands of dollars and many Ohio grain farmers are heavily reliant on credit in order to purchase the farm implements and other supplies needed to operate today's family farm. The loan-interest paid for purchasing these vital tools has always been considered a legitimate business expense.

It's also a fact that farming is facing a rough economic spot. According to the USDA, net farm income in 2017 is forecast to decline for the fourth consecutive year by 8.7% percent to $62.3 billion. At the same time, USDA also predicts farm real estate debt will reach a historic high of $240.7 billion, which is a 5.2% increase from 2016.

Eliminating interest deductibility right now would destroy an important tool that helps today's Ohio grain farmer ensure the success of the family farm. It would also discourage Ohio corn and wheat farmers from operating in tough economic conditions and send a negative signal to the next generation of farmer.

As this committee considers tax reform, please think of the many family farmers in Ohio and please maintain the full deductibility of business interest expense as it exists under current law.

Thank you for your consideration.

cc:
Rep. Pat Tiberi (OH-12)
Rep. Jim Renacci (OH-16)

Sincerely,

Jed Bower, President

Tadd Nicholson, Executive Director

How Tax Reform Will Help Small Business Grow and Create Jobs

Statement for the Record
By
Karen Kerrigan
President & CEO
Small Business & Entrepreneurship Council

Committee on Ways and Means
Tax Policy Subcommittee
U.S. House of Representatives
The Honorable Peter Roskam, Chairman

Statement submitted on:
July 13, 2017

Chairman Roskam, thank you for your leadership, commitment to tax reform, and for your consistent support of entrepreneurs and small businesses.

On behalf of the Small Business & Entrepreneurship Council (SBE Council) and our nationwide membership and network of more than 100,000 members, I am pleased to submit this statement for the record on how tax reform will help small businesses grow and create jobs. Pro-growth tax reform is essential to the growth and competitiveness of the U.S. economy. It is essential that proposals and measures being considered keep the needs of small businesses and entrepreneurs at the center of reform. As you know, small businesses are critical to job creation, innovation and the dynamism in our economy. Our nation needs a tax code that enables small business sustainability and growth.

SBE Council is a nonpartisan, nonprofit advocacy, research and education organization dedicated to protecting small business and promoting entrepreneurship. For nearly 25 years SBE Council has worked to advance a range of policy and private sector initiatives to strengthen the ecosystem for startups and small business growth. Tax system reform is one of our core issues, and a priority issue for small business owners and entrepreneurs.

As the Ways and Means Committee has explored in many hearings, the current tax system is costly and complex. Transforming the system to one that is simple and fair, while allowing business owners to keep more of their earnings, will translate into major gains for our economy including quality job growth. Entrepreneurs plow the bulk of their profits back into their businesses in order to compete more competitively and to reward and retain their workforce. By keeping more of their hard-earned resources through tax reform, the American dream will be restored for these entrepreneurs and their dedicated employees.

Tax reform is vital to the growth of U.S. small businesses and entrepreneurship. Again, the focus of this effort must be on reforms that produce a simple, fair, and productive tax code – one that encourages investment, risk-taking, capital formation, and growth. Indeed, America's small businesses have experienced a challenging operating environment for more than a decade. The financial crises, the Great Recession, followed by the weak economic recovery and policy headwinds from Washington, have increased their business costs and fueled a long period of uncertainty.

For 2017, the direction of policy has obviously changed and small business owners are feeling more optimistic about the policy environment. Our members are pleased that Washington is currently in a period where there is an opportunity to advance policies that create a better U.S. business environment and make our nation more competitive.

Tax Reform Must Encourage Higher Levels of Entrepreneurship

The U.S. tax code needs to encourage small businesses to invest and grow, but it also needs to foster higher levels of new business creation. The dearth in entrepreneurship is a crisis that needs to be addressed on several levels, but sound policies – including tax reform – play a key role.

SBE Council's most recent **"Gap Analysis" report on entrepreneurship** finds a massive shortfall of businesses - some 3.4 million "missing" businesses, compared to where we should be based on historical trends and key data related to incorporated and unincorporated self-employed, and employer firms as shares of the relevant population. SBE Council believes a pro-growth tax system is a critical part of the policy ecosystem that will enable greater levels of entrepreneurship.

In addition to lowering tax rates on all businesses and simplifying the system, tax writers need to consider changes to other parts of the tax code to bring it into the 21st Century. Several thresholds established in the early 1950s have not been updated, and stifle the creation of micro-businesses and early-stage entrepreneurs. For example, the threshold on self-employment taxes kicks in at $400, which is 15.3 percent of profits, but has never been updated. However, the standard deduction on federal income tax is adjusted annually. If the self-employment tax floor had been adjusted at the same rate as the standard deduction, it would be more than $6,000. Also, the 1099-MISC reporting threshold (currently at $600) would be $5,376 if adjusted in today's dollars. Updating both of these thresholds would give the self-employed and early-stage entrepreneurs a better chance for growth. Lifting these barriers would also encourage more people to start businesses.

It would be wise for tax writers to review all thresholds, as well as quarterly reporting dates, to make them more consistent, current, and logical.

A Globally Competitive Tax System is Critical for Small Business Growth and Success

Based in part on tax reform plans that the GOP House leadership and Trump Administration have put forward to date, the foundation for substantive, productive tax reform has been established. The key now is to move forward with measures that unify the business community and entrepreneurs, such as greatly reducing tax rates, allowing expensing of capital expenditures for all businesses, simplifying the tax system, eliminating the AMT and death taxes, and eliminating special-purpose "loopholes," among other measures.

Lower Tax Rates Critical to Entrepreneurs

SBE Council supports reducing both the corporate income tax rate, and the tax rate of pass-through entities. This is vital for U.S. business competitiveness and economic growth.

As you well know, the U.S. imposes one of the **highest corporate tax rates on the planet**. Reducing and reforming the corporate income tax rate is not just a "big business" issue. It's very much about small business. According to the latest Census Bureau data, 86 percent of corporations have less than 20 employees, and 96.7 percent less than 100 workers. Many of these small businesses are in high-growth sectors, and they – as well as their employees and our economy – would benefit tremendously from reducing the corporate rate.

At the same time, it must be recognized that 95 percent of businesses as non-C corporations pay the personal rather than the corporate income tax, which speaks to the need to reduce individual income tax rates as well. Just as the U.S. corporate income tax rate ranks poorly, **our individual rates are not globally competitive.**

As for top personal income tax rates, the 39.6 percent tax rate ranks 106th among 144 nations this year. **T**he news gets worse when factoring in the average state income tax rate (excluding local income tax rates but accounting for the deductibility of state income taxes on federal returns). This adds at least three percentage points to the U.S. rate, taking it up to at least 42.6 percent. That, in turn, pushes the U.S. tax rate global ranking down further to 115th out of 144 nations.

Small business optimism increased markedly following the 2016 elections and it remains strong **in the second quarter of 2017**. But entrepreneurs and small business owners are counting on substantive tax reform – featuring relief from high tax rates and burdens on investment, onerous regulations, and ridiculous complexity – to help bring them to higher levels of growth and confidence. In turn, this will lead to more investment, quality job creation, innovation, and business expansion. With higher levels of growth (and more opportunity), the U.S. will also experience enhanced business startups, which means more dynamism, innovation and quality job creation for our economy.

SBE Council's hope is that the House and Senate accelerate the pace of tax reform, so that small business owners and entrepreneurs can plan for a better tax system in 2018. Again, lowering rates for all, vastly simplifying the system, making the system fair and productive to encourage growth is vital to U.S. competitiveness and leadership in the global economy. With this in mind, we are hopeful your committee will continue to keep entrepreneurs and small businesses at the center of your reform efforts. SBE Council and our members pledge to work with you every step of the way to ensure the U.S. has a modern, pro-growth tax system that does not stand in the way of opportunity and entrepreneurship in America.

Thank you for considering the views of SBE Council and our members.

Respectfully submitted,
Karen Kerrigan, President & CEO
Small Business & Entrepreneurship Council

SMALL BUSINESS MAJORITY

July 17, 2017

U.S. House of Representatives
Committee on Ways and Means
Tax Policy Subcommittee
1102 Longworth House Office Building
Washington D.C. 20515

RE: Hearing on How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs

Dear Chairman Roskam, Ranking Member Doggett and fellow Subcommittee Members:

As a leading representative of the 28 million small businesses in America, Small Business Majority is writing in response to the House Committee on Ways and Means Tax Policy Subcommittee's recent hearing on the effects of tax reform on small businesses.

Small Business Majority was founded and is run by small business owners to ensure America's entrepreneurs are a key part of an inclusive, equitable and diverse economy. We actively engage our network of more than 55,000 small business owners in support of public policy solutions and deliver information and resources to entrepreneurs that promote small business growth.

For too long, our nation's tax system has benefited the wealthiest Americans and large multinational corporations—leaving the rest of the country, particularly small business owners, to foot the bill. Small Business Majority's polling found 90% of small business owners believe big corporations are using loopholes to avoid taxes that small businesses have to pay, and 92% believe corporations' use of those loopholes is a problem.[i] Similarly, 9 out of 10 small business owners believe that the fact that U.S. multinational corporations' use of these loopholes to shift U.S. profits overseas is a problem.

Our country's largest companies don't need a tax break; rather, we need a tax system that benefits America's entrepreneurs who are focused on growing their enterprises and making payroll at the end of each month. As such, we must ensure that any substantive changes to the tax code benefit all small businesses by promoting economic development from the bottom-up. While small businesses can certainly benefit from a reduction in corporate tax rates, these reductions must be accompanied by the elimination of costly loopholes that only benefit large corporations.

Additionally, giving a tax credit to the top 1% of wealthy individuals, very few of whom own small businesses or family farms, won't do our economy any favors. This will benefit virtually no small businesses and will expand the deficit to unmanageable levels, ensuring that small business owners and other ordinary taxpayers will be left to foot the bill.

That's why we're concerned by the White House's outlined proposal for tax reform. We believe the proposal would hurt small businesses because it would drastically increase the deficit by lowering the corporate rate to 15% without getting rid of corporate tax loopholes. Indeed, the White House's proposal would add a vast $5.5 trillion to the deficit over 10 years.[ii] Likewise, Speaker Ryan's tax reform plan to lower the corporate rate to 25% would result in $3.1 trillion in lost revenues in the first decade.[iii] Instead, small businesses want tax reform that will level the playing field so that they are not stuck footing the bill when large corporations take advantage of loopholes and avoid paying their fair share.

While some claim the White House's proposal to cap the tax rate for pass-through entities to 15% would be a boon for small business, in fact, this would impact very few small firms. Nearly 7 in 10 pass-through entities already pay 15% or less.[iv] Instead, this proposal would primarily benefit hedge fund managers, lobbyists, lawyers and investment bankers—not Main Street small businesses.

Additionally, the White House's repatriation proposal fails to address the substantial tax advantage given to big businesses because it fails to address the loophole that allows multi-national corporations to defer paying taxes on foreign profits. This loophole costs the U.S. Treasury Department more than $1 trillion over 10 years, and only serves to benefit a select number of multi-nationals at the expense of small businesses.

What's more, this proposal seems to perpetuate the myth that ending the estate tax will help small business owners. In reality, the estate tax, which only applies to estates valued above $11 million for married couples, impacts only about 50 of our nation's 28 million small businesses and small farms.[v]

We must implement policies that will help all entrepreneurs—from the Main Street restaurants and independent retailers, to the consulting firm with 25 employees and the solo-entrepreneur just getting their business off the ground—rather than giving a tax break to those who need it least.

Small Business Majority Tax Reform Recommendations

In sum, any reforms to the nation's tax code must level the playing field, simplify the tax code and ensure fairness for small businesses. We believe this must include:

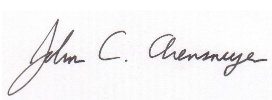
- Eliminating unfair corporate loopholes while responsibly lowering business tax rates in a manner that ensures a net revenue increase to bring down our deficit and fund key programs.
- Ensuring any changes to the corporate and personal tax code have a significant, direct benefit to small businesses, as opposed to large businesses and hedge funds.
- Allowing pass-though entities and C-Corp small businesses to deduct their first $25,000 of profit, supporting small businesses from the bottom-up rather than the top-down proposal to lower rates to 25%, 20% or 15%. This policy could be accompanied by a phase-out for businesses with more than $150,000 in income. This will benefit the vast majority of businesses (70%) at the lower end of the income spectrum. [vi]
- Cracking down on the ability of large corporations to reduce their tax burden simply by parking their profits offshore or moving their headquarters outside the country.
- Ending the ability of corporations to defer paying taxes on offshore profits, which hurts the economy, costs the U.S. more than $1 trillion over 10 years and creates an unequal playing field for small businesses that are paying their fair share. Any attempt to repatriate existing offshore profits in exchange for a lower rate, without ending the deferral moving forward, will only perpetuate this costly inequity in our system.
- Ending other inequitable corporate loopholes:
    - Accelerated depreciation: Most small business owners don't have large enough capital expenditures to benefit from this loophole that costs $400-600 billion over 10 years.
    - U.S. production/manufacturing credit: This credit benefits large corporate special interests and costs $190 billion over 10 years.

    - Carried interest: This loophole only benefits hedge funds by allowing them to pay taxes on ordinary income at special lower capital gains rates while costing the U.S. $20 billion over 10 years.

- Upholding the estate tax in its current form, understanding that it currently protects virtually all small businesses and family farms.
- Ensuring parity between online and bricks-and-mortar businesses with a reasonable and fair Internet sales tax solution.
- Simplifying and expanding the small business tax credit created by the Affordable Care Act—helping more small businesses qualify for and utilize it.
- Passing healthcare tax equity for the self-employed so that freelancers can deduct their healthcare expenses from their FICA tax obligations.
- Creating tax incentives for angel investors. More than half of states offer tax incentives for angel investors. Federal support of these efforts would encourage more local and state governments to consider such measures.

Tax reform is critically needed, but any new policy needs to approach reform in a way that ensures fairness for small businesses so our nation's job creators can compete. We urge you to enact reforms that will support all entrepreneurs from the bottom up to promote a thriving small business economy.

Sincerely,



John Arensmeyer
Founder and CEO

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[i] http://www.smallbusinessmajority.org/our-research/taxes-budget-economy

[ii] http://www.crfb.org/blogs/how-much-will-trumps-tax-plan-cost

[iii] http://www.taxpolicycenter.org/publications/analysis-house-gop-tax-plan/full

[iv] http://www.taxpolicycenter.org/model-estimates/distribution-business-income-august-2016/t16-0185-sources-flow-through-business

[v] http://www.taxpolicycenter.org/model-estimates/baseline-estate-tax-tables-nov-2016/t16-0277-current-law-distribution-gross-estate

[vi] https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/TP-4.pdf