



**U.S. House of Representatives Committee on Small Business Hearing:
“The Tax Law’s Impact on Main Street”
Wednesday, July, 25, 2018**

**Statement of K. Davis Senseman
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Chairman Chabot, Ranking Member Velázquez, and members of the committee:

Thank you for the invitation to testify today examining how the Tax Cuts and Jobs Act has affected real Main Street small businesses.

My name is Davis Senseman and I am a member of Main Street Alliance, a national network of over 30,000 small business owners. I also serve on the Executive Committee of Main Street Alliance of Minnesota, a statewide network of small business owners. Our network creates opportunities for small business owners to speak for ourselves on matters of public policy that impact our businesses, our employees, and the communities we serve.

I’ve been a small business owner for more than eight years and I currently employ five people. I am the founder of a full-service law firm for small and medium sized businesses. We have a roster of over 900 small business clients, the majority of which are located across the state of Minnesota. My entire job as a small business attorney is to review and advise my clients on whether something that is being proposed to them is a good idea or a bad idea.

I have spent quite a bit of my time with clients since last fall trying to figure out what the TCJA meant for them and their business, as well as figuring out what it meant for my own firm. I will speak today from both of these perspectives, and will have four primary points.

First, the majority of small businesses in Minnesota and across the country are not seeing consequential gains from the TJCA. It is nice that the folks who spoke earlier today are, but they are most certainly the exception, not the rule, and from what they offered as concerns to their business, I wonder how many Americans would actually classify them as “small”.

Second, and I can’t imagine this comes as a surprise to anyone in this room - the Act’s small business provisions were quite confusing for all but the most sophisticated small business owner.

Many business owners, including several of my clients, will see nearly all of the savings the Act may have provided eaten up by attorney and accounting fees, as they paid experts like myself to parse through the Act and advise them on their best next move.

Third, to build an equitable economy that works for small business owners like me and my hundreds of clients, large corporations and wealthy individuals must pay their fair share of taxes. Small business owners know this, because healthy communities with safe roads and funded schools ensure that our customers can get to our businesses, will have money to spend there and that our future workforce will be educated and able to staff our businesses.

And my fourth and final point is one perhaps only a lawyer can make and that is that no matter what you believe in the theories of trickle-down or up economics, the system of American corporate law (and the case of a small business owner named Ford and his activist shareholder named Dodge) simply forbids corporations from doing anything that doesn't provide the greatest economic benefit to their shareholders, and that this is why a corporate tax cut, no matter what size business it is aimed at, can never bring about the greatest economic stimulus for Americans.

I. How will the pass-through tax deduction impact Main Street?

The most significant change in the TJCA that directly impacts small businesses is the creation of a new 20% deduction for owners of pass-through entities. As this committee knows, a wide variety of businesses are structured as pass-throughs, ranging from mom-and-pop shops to law firms to massive hedge funds.

While this provision has been lauded as a boon for small business, in practice, it's another major tax cut for very wealthy individuals. The median income for a self-employed individual with an incorporated business in the United States was \$49,204 in 2014, the last year for which the SBA has data.¹ These businesses are the bodegas, auto mechanics, family restaurants, and small farmers who would have to pay more to a tax attorney like myself or an accountant to figure out the new law than they would reap in tax cuts, or who are seeing increases in health insurance premiums that outweigh any nominal tax cut they might receive.

The median income statistic may make it seem like most of the benefit for pass-throughs would then go to those who need it the most - after all, a median of \$49,204 is pretty low, so the top earners can't make that much right? Wrong - that was businesses where the owners actually WORKED there.

Overall, income from pass-through businesses skews heavily to the very wealthy, with 70 percent of pass-through income accruing to the top 1 percent of income earners.² That income is often "earned" in the loosest definition of the word, and certainly not through being employed by the business. In fact, The Joint Committee on Taxation (JCT) recently found that by 2024, 61 percent of the benefits of the pass through deduction will accrue to the wealthiest 1 percent of pass-through business owners, while just 4 percent will go to the bottom two-thirds, including

¹ https://www.sba.gov/sites/default/files/advocacy/United_States.pdf

² www.brookings.edu/research/9-facts-about-pass-through-businesses/

real Main Street shops that personify small business. The top 1 percent will see a benefit that is 15 times larger than what the bottom two thirds of business owners will receive.³⁴

It's evident that wealthy business owners stand to benefit far more from this new deduction than real small business owners. While writers of the tax bill claim they built guardrails into the law that keep the investment bankers and Wall Street lawyers from using the tax break once their income reaches a certain level. But savvy, highly-paid accountants are already figuring out how to game the system and restructure their clients' businesses to claim the maximum benefit from the new law⁵, while real small businesses are left uncertain and struggling to understand the changes.

II. The TCJA is breeding confusion and uncertainty

For years business advisors like me instructed our clients who were creating new businesses that in the vast majority of cases, one should be structured as an LLC until you are making over a certain amount in income, at which time switching to a S corporation may result in a better tax situation. The TCJA turned this advice on its head, and now two businesses making the same amount of money may have completely different tax situations - thus, many small business owners on Main Street are stuck with an S election that now causes them to pay far higher taxes than if they had never made such election. Further compounding the issue is the fact that the IRS does not allow one to change your business tax election for five years after you make it, so there is no quick fix that won't also allow absolute gaming of the tax system.

There is also so much uncertainty in the law that it's actually still quite hard to find an accountant who can give you a simple yes or no answer about whether you should restructure your small business to even see a potential nominal benefit from the law. We sit here today, July 25, and have yet to see the regulations the IRS promised would be out by July at the latest to provide any reassurance around the new Act.

For my personal business, my partners and I sit in a very privileged position because we are attorneys who advise small businesses. We did decide to restructure our business to take maximum advantage of the tax law, and still had to spend a great deal of money with our accountant figuring out the details - I would put the final figure between \$2,000-\$3000. That means that, in the first year at least, what we will save in taxes will be pretty much outweighed by what we spent to figure it out, and again, we are in such a unique position since we only have to spend money on accountants. I would double what we spent for any other small businesses because they will need to talk to their attorneys as well.

For real Main Street small business owners, what they would spend on accountants and attorneys often outweighs any small benefit they may see from restructuring.

³ <https://www.jct.gov/publications.html?func=startdown&id=5093>

⁴ <https://www.cbpp.org/blog/jct-highlights-pass-through-deductions-tilt-toward-the-top>

⁵ https://www.washingtonpost.com/business/on-small-business/rich-professionals-can-exploit-tax-break-for-farms-small-firms/2018/03/06/0e3b36ac-2132-11e8-946c-9420060cb7bd_story.html?utm_term=.44a410b505ae

III. The TJCA will balloon the deficit, is an attack on healthcare and is the wrong way to spur small business growth

While most of Main Street won't feel much of the benefits of the TJCA, they will feel the brunt of its impact. The Congressional Budget Office (CBO) estimates that the TJCA will slash government revenue by \$1.3 trillion from 2018 to 2028, and when the cost of paying interest on that debt is included, the TJCA will add a total of \$1.9 trillion to the deficit.⁶ As many predicted, some of your colleagues are using this deficit increase to justify deep cuts to Social Security, Medicare, Medicaid, education, infrastructure, as well as food, rental and energy assistance, and other vital public services that tens of millions of people—including small business owners and our communities--rely on.⁷

Many Republicans were ardent opponents of any increase in the federal deficit when President Obama wanted to invest in critical human needs programs, but now remain quiet in the face of a burgeoning deficit due to the tax law. The CBO has said that the TJCA is expected to increase growth by .7 (7/10ths) of a percent over the next decade, but even with that, it won't be close the 2.9 percent growth that the Trump Administration said would cover the cost of the tax law.⁸

The nonpartisan Tax Policy Center, estimates that a typical small business owner (those folks with the median income of \$49,204) would experience a tax cut of roughly \$500 in 2018.⁹ In my experience, folks who make \$49,204 are generally one catastrophe away from needing a myriad of social services funded by our tax base. In Minnesota, they are worried about whether there will be enough money to fund MinnesotaCare, our state Medicaid program, or if they can access heating assistance if their business suffers a down month during our tough Minnesota winters. You'd be hard pressed to find a true Minnesota small business owner who would rather have \$500 in hand now than an assurance that help would be there if they need it in the future.

Crumbling and outdated infrastructure has caused small business owners to experience increased transportation costs as well as a variety of health and safety issues. The lack of broadband internet connectivity in many rural communities has hampered business growth and development. Robust public investment in sustainable and resilient infrastructure would help increase business efficiency, widen the consumer base, and ensure safe and healthy communities, all things that boost a Main Street business's bottom line more than \$500 per year.

Furthermore, a lack of adequate investment in the public education system has led to shrinking school budgets, increased class sizes, shortened school years, and the loss of many school programs. Small business owners rely on a strong public school system to ensure a well-educated, prepared workforce for the future.

a. The TJCA is part of a larger assault on healthcare

⁶ <https://www.cbo.gov/system/files?file=2018-06/53919-2018ltbo.pdf>

⁷ <https://www.cbpp.org/research/federal-budget/house-gop-budget-retains-tax-cuts-for-the-wealthy-proposes-deep-program-cuts>

⁸ <https://www.treasury.gov/press-center/press-releases/Documents/TreasuryGrowthMemo12-11-17.pdf>

⁹ <https://www.taxpolicycenter.org/publications/distributional-analysis-conference-agreement-tax-cuts-and-jobs-act/full>

In addition to the aforementioned cuts, the CBO found that the TJCA's repeal of the individual mandate will cause 13 million Americans to lose access to healthcare and health insurance premiums to increase by an average of 10 percent.¹⁰ But coupled with additional attacks on the ACA, including the expansion of junk and short-term health plans by the Trump Administration, and judicial attacks on preexisting conditions, the Urban Institute found that 17.1 million people would lose coverage in 2019, a 50 percent increase in just a single year as a result of the attacks on the ACA¹¹. This is over and above the impact of zeroing out the individual mandate penalty.

These acts will destabilize the individual and small group markets, driving up costs for the most vulnerable enrollees. This will devastate small business owners already struggling to afford insurance for themselves or their employees. Small businesses fund their expenditures from month to month, and need predictability to make business decisions. Erratic premium increases undermine their ability to project expenses. As health care costs skyrocket and families are forced to pay more for vital healthcare services, they will have less money to spend at local businesses, causing consumer demand to plummet.

Moreover, this limits who will be able to take on the risk of becoming an entrepreneur. I started my firm in 2010, the first year that the provisions of the Affordable Care Act took effect, and a time when the large corporations in Minnesota were still reducing their workforces from the last recession. Do you know what I spent most of my time doing in those months? Creating LLCs and drafting agreements for folks who had been laid off from the General Mills and Best Buy and other large companies but who had decided they would be take the risk to start their own business because they were no longer reliant on a large company to provide them health insurance.

Small business owners need a foundation of social stability to succeed, and the lack of access to quality, affordable health care is a barrier to starting or expanding a business. Every tear in the social safety net prevents people from pursuing their dream of small business ownership, stifling innovation.

b. The TJCA will not cause small businesses to grow their businesses

As I previously stated, in future years, once we have recouped the costs of our accountants, the TCJA will likely result in my law partners and I having a smaller tax burden. But it certainly won't be enough to hire more staff. And it won't be enough that any of the other small businesses we work with will feel the effect. In fact, businesses hire more people only when there is enough demand to warrant more employees. This is underscored by a recent poll by Businesses for Responsible Tax Reform, which found that 69 percent of small business owners do not plan on hiring a new employee because of the new tax law, and 59 percent do not plan to give current employees raises.¹²

¹⁰ <https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53300-individualmandate.pdf>

¹¹ https://www.urban.org/sites/default/files/publication/98634/aca-remains-critical_2001873_1.pdf

¹² https://docs.wixstatic.com/ugd/4a8609_a801668b62ff4d9bacfe8b9fadacb995.pdf

Main Street's ability to create jobs is particularly important to economic growth because small businesses employ nearly 50 percent of the country's private sector workforce, that is 58 million out of the 121 million private sector employees.¹³ The Small Business Administration found that since 1993, small businesses, not large companies, created 62 percent of the country's net new private sector jobs.¹⁴ And since the end of the Great Recession, small businesses have created 2 out of 3 private sectors jobs.¹⁵

IV. Why corporate tax cuts will never spur national prosperity

Wealthy corporations and their shareholders are reaping the majority of the benefits from the TJCA. In fact, 156 companies have been identified as receiving \$77.3 billion in total tax cuts and authorizations for stock buybacks have increased by \$615 billion since the passage of the bill. On the other hand, just 4.3 percent of workers are getting any one-time bonuses or wage increases from their employers¹⁶.

I'd like to close my testimony with a story about an early US small business owner, Henry Ford. Due to the Model-T's success and an innovative assembly line, Ford Motor Co. amassed a capital surplus of \$60 million by 1916. With this money, Henry Ford wanted to employ more workers, make the autos affordable for the assembly workers, and help workers build their lives. Sounds a bit like the promise of the TCJA doesn't it?

Unfortunately Dodge, a minority shareholder, disagreed with this plan and filed suit against Ford arguing that the purpose of the company was to maximize shareholder profits – and not to benefit the community by making affordable cars or employing more workers. The court agreed, holding that management's primary duty is to maximize shareholder wealth. This case remains law today, and fairly clearly confirms, that any attempt to stimulate the economy and create jobs by making sure that businesses have more money will soon run into the issue that those same companies are legally obliged to use any surplus money to benefit their shareholders - not the greater good.

IV. Closing

The stated purpose of the TJCA was to stimulate the US economy. As my testimony, the supporting citations and the cautionary tale of Dodge v. Ford make clear, the methods employed in the Act did not have that intended effect. In order to create a more equitable economy with broadly shared prosperity on Main Streets across the country, it's imperative to reform the tax and transfer system, and ensure wealthy corporations and individuals pay their fair share of taxes. This includes eliminating corporate tax loopholes that enable tax evasion and incentivize offshoring, as well as creating a more balanced income tax structure.

If lawmakers in DC are the champions of small business they claim to be, you must ensure that our tax code prioritizes strong public investment over corporate profits. For the vast majority of

¹³ <https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2017-WEB.pdf>

¹⁴ <https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2017-WEB.pdf>

¹⁵ https://www.sba.gov/sites/default/files/Job_Creation_fact_sheet_FINAL_0.pdf

¹⁶ <https://americansfortaxfairness.org/key-facts-american-corporations-really-trump-tax-cuts/>

small business owners, paying marginally less in taxes has little benefit when compared with a good, affordable healthcare system; sufficient retirement funds; and high-quality jobs that sustain a strong customer base. Congress has its work cut out for itself to fix these significant challenges.