SMALL BUSINESS TAX REFORM: GROWTH THROUGH SIMPLICITY

HEARING

BEFORE THE

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UNITED STATES
HOUSE OF REPRESENTATIVES

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SMALL BUSINESS TAX REFORM: GROWTH THROUGH SIMPLICITY

WEDNESDAY, APRIL 10, 2013

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 1:00 p.m., in Room 2360, Rayburn House Office Building. Hon. Sam Graves [chairman of the Committee] presiding.

Present: Representatives Graves, Luetkemeyer, Mulvaney, Hanna, Huelskamp, Schweikert, Bentivolio, Velázquez, Schrader, Clarke, Chu, Payne, Meng and Barber.

Chairman GRAVES. We will call this hearing to order. I want to thank all of you for joining us here today as we discuss tax reform and its importance on small business. I am very much looking forward to the testimony of our distinguished guests.

Over time, our tax code has become more complex and temporary, with tax relief being extended for one year, months at a time, or even retroactively, taxpayers, and particularly small business owners, repeatedly complain that this uncertainty, coupled with new taxes, regulations, and the weak economy, have made it difficult to play or grow their companies.

Small businesses are disproportionately affected by tax complicity. A study by the Small Business Administration's Office of Advocacy disclosed that small firms pay 67 percent more to comply with the tax code than large firms do, and a growing number of provisions, along with the fact that small firms frequently do not have an in-house account with their tax attorney means that small business owners must hire outside experts or add those duties to another employee's workload.

For these and many other reasons, small business owners have urged Congress to address tax reform. But "tax reform" can mean different things to different people. And since I have been chairman, the Small Business Committee has held 10 hearings dedicated to highlighting the negative impact the complex tax code has had on small firms. We have additionally, created an open mike web platform that allows small businesses from outside the beltway to communicate with our committee on any issues affecting their businesses. Nearly all those small businesses, whether they were here in this room or via the "Open Mic" project, have consistently asked for simplification of the tax code and reduced tax rates both for corporations and individuals.

For the past few years, many members of Congress and the administration have said that tax reform is an important agenda

item, and since the beginning of the 112th Congress, the Ways and Means Committee chairman, Dave Camp, has held over 20 hearings focusing on tax reform at all levels. He has also established 11 bipartisan working groups of members of Congress who have met with hundreds of associations, think tanks, and interested parties in an effort to put forth transparent, comprehensive, and truly bipartisan proposals to reform and simplify the tax code. And over the past few months, the Ways and Means Committee has released discussion drafts of legislation reform in corporate and individual rates, international taxes, and financial products.

Which leads us to why we are here today. On March 10, 2013, Chairman Camp issued a discussion draft of a tax reform plan for small businesses. As part of the larger effort to reform various portions of the tax code, this draft would, among other things, make Section 179 expensing for equipment and property permanent, simplify and expand the use of cash accounting for certain small firms, create a unified deduction for start-up and organizational expenses, and provide two options for reform of the Federal Tax Rules applicable to pass-through businesses. This is truly an excellent place to start, and I commend Chairman Camp on his efforts so far. I am looking forward to hearing from all of our witnesses today and what they have to say about this draft legislation so we can offer further recommendations to our colleagues on the tax writing committee. This is really an open and transparent process.

And with that I will turn to Ranking Member Velázquez for her opening statement.

Ms. VELÁZQUEZ. Thank you, Chairman Graves. And welcome.

Chairman GRAVES. Thank you.

Ms. VELÁZQUEZ. The American marketplace is perpetually evolving, but while its vibrant nature has spurred growth and innovation, it has also managed to outgrow many tax policies. As a resort, we often come across provisions in need of reassessment. Such is the nature of our current tax code, which must be reviewed and redesigned to be made simpler and more effective for our nation's small businesses. While some of the existing tax policies provide critical small business tax breaks, much of the code is riddled with flagrant inequities and unnecessary complexities. For small firms, this creates an obstacle to success, rather than a means of encouraging growth and job creation.

This Committee is well aware of the challenges created by the Internal Revenue Code and the major complications it has on business planning. Given that the last major reform of the code took place in 1986, it is clear changes are long overdue and that we cannot go forward without input from small business owners and entrepreneurs. With that in mind, it is important that we continue our progress towards comprehensive tax reform to spur innovation and stimulate small businesses. Failure to take any action, however, creates greater uncertainty and damps the outlook for small businesses.

Comprehensive reform will have immediate benefits for small businesses, while also serving our nation's economic objective of promoting pro growth policies, devoting reform efforts on a complete overhaul of the code, support our nation's job creators by allowing them to continue hiring and expanding without worrying

about annual changes. Most importantly, any agreed upon plan must ensure the extension of enhanced business expense and provisions. This will help to encourage small entities to make purchases now while also putting more money back in their pockets to invest and hire.

One thing is clear. As we talk about tax reform, the needs of small businesses must come first. We cannot move forward without their input, and we must fully recognize the impact of how any proposals will affect them. Small businesses are the drivers of the nation's economy and we cannot afford to put the costs of collecting taxes on them. Instead, we should be working together to help them thrive. This entails a complete restricting of the tax code rather than a piecemeal approach.

A corporate-only method disregards the importance of pass-through entities as drivers of the economy. It will be unwise to ignore their needs during the tax reform debates because when they do well, we all do well. It is clear that small businesses and our economy can come out winners if we approach tax reform in a comprehensive manner. It is my hope that we can address this issue immediately. If Congress acts quickly, small firms will see immediate benefits through a fairer and simpler tax code. The only reason for delay will be to keep a political issue alive.

Today's hearing will hopefully start an ongoing dialogue between the small business community and policymakers regarding which tax proposals best support the success of small firms. I believe there exists an opportunity for this Congress to implement long-lasting reforms. Doing so will have immediate benefits for small businesses. It will also ensure the nation's long-term economic growth. I stand committed to working in a bipartisan way to revise policies that stifle entrepreneurship, innovation, and growth.

With that, let me welcome Chairman Camp to this Committee, as well as the small business owners who have taken time from their busy schedule to be here today. Thank you. And I yield back.

Chairman GRAVES. I am not going to make the introduction long, but obviously starting off the hearing is the Honorable Dave Camp, who is chairman of the Ways and Means Committee. Chairman, I appreciate you coming in. I know we are short on time, and I look forward to hearing from you.

STATEMENT OF DAVE CAMP, CHAIRMAN, WAYS AND MEANS COMMITTEE

Mr. CAMP. Thank you. Good afternoon, Chairman Graves and Ranking Member Velázquez and members of the House Small Business Committee. As a former member of the Committee, it is great to be back.

I also want to take a moment to thank the small business owners who will appear on the next panel. Taking time away from their business is a big deal, and they have firsthand knowledge of just how broken our tax code is, how much time and energy it takes to comply with it, and what it means for them and their employees. That means fewer resources for them to hire new workers and provide benefits. They deserve a tax code that works for them in a better way. So I appreciate them coming to share their ideas and adding their voice to the dialogue.

In preparation for today's hearing I did a little research, and the last Chairman of the Ways and Means Committee to testify before the Small Business Committee was Al Ullman in 1979. So it was nearly that long ago that Congress reformed the tax code. Instead of making the tax code better, Congress has spent the last 27 years tinkering with the code, adding special provisions, making the code less effective and less efficient. That is something we must correct, especially for America's small businesses and their workers.

Most Americans get their paychecks from a small business than any other type of business or government. And if we really want to strengthen our economy and put more money in the pocket of American workers and families, we must fix the tax code and how it treats small businesses.

Last month, I released a discussion draft aimed at creating a simpler and fairer code for small businesses. The discussion draft is part of a broader comprehensive tax reform package that significantly lowers rates for individuals, small businesses, and corporations. The goal of the draft is to spur greater job creation and higher wages by reducing the burden of the tax code and the burden that it has imposed on small business.

According to the National Federation of Independent Business, tax compliance costs are 65 percent higher for small businesses than for big businesses, costing business owners $18 to $19 billion per year. In addition, nearly 9 out of every 10 small businesses rely on an outside tax preparer to do their returns.

So with about half of the private sector workforce employed by small business—nearly 60 million Americans—these costs, along with the Federal tax rate as high as 44.6 percent, are especially burdensome for a sector that has long been responsible for leading the nation out of economic downturns.

The discussion draft includes a number of core provisions that are designed to simplify tax compliance for small businesses, whether organized as sole proprietorships, partnerships, LLCs, or corporations. These proposals are not partisan. Democrats and Republicans have championed these ideas, and small business organizations across the country have supported them. The core provisions in the draft would:

Spur investment in equipment needed to grow business operations by providing permanent expensing of investments and property under section 179 of the tax code;

Simplify tax accounting practices by expanding the use of simpler "cash accounting" method to businesses with gross receipts of $10 million or less;

Provide relief for start-up organizational costs by establishing a unified deduction for these expenses; and

Make tax compliance easier for partners and S corporation shareholders by reordering and simplifying the due dates of tax returns for partners and S corporations.

In addition, the discussion draft includes two separate options designed to have greater uniformity between the two main types of pass-through entities: S corporations and partnerships.

One option is an incremental approach that improves the ability of S corporations to compete, grow, and gain access to capital by

modernizing current tax rules affecting S corporations and partnerships.

Option 2 is a more transformative approach that simplifies the tax treatment of nonpublicly traded companies by repealing existing tax rules governing partnerships and S corporations and replacing those rules with a new unified pass-through regime.

Since we released the draft, we have actively sought feedback from the small business community. The International Franchise Association, for instance, has said, and I am quoting, "The proposal would reduce compliance costs and provide greater certainty to the more than 8 million employees across the country who wake up every day and go to work in the franchise industry and those Americans who aspire to become franchise business owners."

And Mr. Chairman, I will not read all the comments that we have received, but I do have a packet of feedback I am happy to share with the Committee Members, and I have included that in my formal testimony.

Simply put, the tax code ought to be easier to understand and less expensive for small businesses to comply with—because every dollar they are not spending on taxes and tax compliance is a dollar they have to invest in equipment, start a new production line, hire a new employee, or provide more in wages and benefits. And that is my goal for comprehensive tax reform—a simpler, fairer tax code that leads to more jobs and higher wages.

Thank you very much.

Chairman GRAVES. I appreciate it, Chairman. And since we are obviously out of time and we have got a vote, which we will reconvene the hearing right after this, Chairman Camp does have to leave but he has said just submit questions in writing. His Committee would be more than happy to answer them. So just do it in writing and he will get those answered. So thank you very much for testifying. And we stand in recess at least for two votes.

[Recess]

Chairman GRAVES. All right. We will bring the hearing back to order. I apologize for the vote series in the middle of our hearing. It happens from time to time, but I do apologize for the delay.

Our first witness on our second panel today is Mr. Sam Griffith, who is the President and CEO of the National Jet Company in LaVale, Maryland. National Jet is known for its micro hole drilling expertise and serves the aerospace, automotive, electrical, medical, and textile industries. Mr. Griffith purchased National Jet in 1992 and currently has 24 employees. Today he is testifying on behalf of the National Tooling and Machining Association. I thank you for being here today and look forward to your testimony.

STATEMENTS OF SAM GRIFFITH, PRESIDENT AND CEO, NATIONAL JET COMPANY; STEVE BEARDEN, PRESIDENT AND CEO, LINEMARK PRINTING; TIM WATTERS, PRESIDENT AND CEO OF HOFFMAN EQUIPMENT; ROGER HARRIS, PRESIDENT AND COO, PADGETT BUSINESS SERVICES

STATEMENT OF SAM GRIFFITH

Mr. GRIFFITH. Thank you for the opportunity to testify before you today on the impact of tax reform on small businesses. My

name is Sam Griffith; I am president and CEO of National Jet Company in LaVale, Maryland. I am also a member of the National Tooling and Machining Association (NTMA) and I am testifying here today on behalf of both my company and the NTMA.

I am also a Certified Public Accountant (CPA). I began my career practicing as a CPA with the international firm of Price Waterhouse Coopers.

National Jet Company, which I purchased in 1992, was found in 1937, today is an internationally known expert in precision micro hole drilling technology. We can drill a human in a human hair to give you an idea of size. We service primarily the aerospace, automotive, medical, and textile industries.

National Jet is structured as a subchapter S corporation, which means all income flows from the company to my personal return, which puts me into a much higher tax bracket than I normally would be due to the pass through.

Given my combined training as a CPA and having worked in both the C and a S corporation provides me with a unique perspective on tax policy.

The NTMA and I wholeheartedly support tax reform that includes real reform for both C corporations and pass-through companies. We desperately need lower rates, simplification of rules, and elimination of sunset provisions in the tax code. It is very difficult to play into the future when there is such uncertainty in the tax code.

Why do most businesses use a pass-through entity? The reason is obvious. The double taxation of C corporation dividends which the owners pay when they take their earnings out of the business. No one wants to pay double taxes on their hard earned income. After all, when the owner pays a higher tax rate there is less revenue to buy equipment and hire employees. The fewer resources we have available, the more difficult it is to expand.

Based on a December 2012 survey, the National Tooling Machine Association, 200 respondents identified the most used tax credits and deductions. They are section 179 Equipment Expensing; Bonus "accelerated" Depreciation; R&D Tax Credit; Section 199 Domestic Production Activities Deduction; LIFO inventory valuation.

National Jet, in 2011, we claimed $400,000 in section 179 equipment deduction; however, in 2012, the section 179 limit was $139,000, and a phase-out if you purchased over $560,000 in equipment. Our company needed a machine that cost $611,000, but if you purchased this equipment in 2012, we would lose section 179 deduction because it exceeded the limit. This one piece of equipment exceeded the entire limit. Therefore, I only purchased $130,000 worth of smaller equipment to stay within the threshold of the tax provision. Then Congress, on December 30, one day before year-end as part of the fiscal cliff, passed a provision increasing the section 179 to $500,000 and increased the phase-out to 2 million.

Now, how could any small business react to this? One day in which to purchase a machine that weighs 36,000 pounds, transport it, have electrical lines installed, have airlines installed, and place it in service within 24 hours. No one could react to this. Small busi-

ness did not get the benefit based on this last minute act of Congress.

Another issue which received a lot of headlines in tax reform that is discussed is Alternative Minimum Tax (AMT). Because our business is captured under AMT, we cannot claim the R&D tax credit, which would be available to us because we are a leading-edge technology. In 2012, we could have received $30,000 in R&D credits. This was lost to us because the AMT limitation.

In addition, when I hired a long-term unemployed person in my shop last year, I thought I could claim the $1,000 credit Congress passed under the hire act. Again, because I am subject to AMT, I cannot claim that credit. So you give us credits for R&D and employing workers who have lost their unemployment benefits, and then you take them away because of AMT. Why?

As you can see, the current tax code is a maze of mismatched, complex provisions that provide disincentives to grow our businesses and hire new employees.

We fully support Chairman Dave Camp's approach to push for comprehensive tax reform and applaud this Committee for holding this hearing to focus on the impact of small businesses. Our greatest concern is the seeming obsession with corporate-only tax reform—a path which leaves America's small businesses and manufacturers behind.

I believe we must develop a reformed tax code which encourages manufacturing in America and helps our small businesses compete globally in the 21st Century. Small business has a stake in this great country and we want our voice heard.

That concludes my testimony.

Chairman GRAVES. Our next witness is Mr. Steve Bearden, who is the president of Linemark Printing, a full-service printing, graphics, and communication company at Upper Marlboro, Maryland. He participates in a variety of professional-related projects and associations such as serving as board member for the Printing and Graphics Association of the Mid-Atlantic. He is testifying today on behalf of the Printing Industries of America. Welcome to the Small Business Committee.

STATEMENT OF STEVEN BEARDEN

Mr. BEARDEN. Chairman Graves, Ranking Member Velázquez, and members of the Committee, good afternoon, and thank you for inviting me today.

I am Steve Bearden, president of Linemark, a private-owned union printing and graphics communications company headquartered in Upper Marlboro, Maryland. Linemark is a 27-year-old company that employs 92 workers. I am also here as a member of the Printing and Graphics Association of the Mid-Atlantic and of the Printing Industries of America.

Despite tough economic times that saw our industry lose over 75,000 jobs in the past four years, printing companies like Linemark are ready to come back. It is critical tax policies that are in place that will us to do so.

Chairman Camp's overall goal of simplifying tax rules concerning small business in order to reduce the impact of tax costs and com-

plexity is one both Printing Industries of America and I personally can and do support.

My comments this afternoon will focus on three specific provisions of the discussion draft.

The first is making permanent section 179 expensing to allow Linemark and other small businesses to deduct investments in new equipment and property up to $250,000.

This provision is vital to the future growth and job creation of my company and others like it. In the environment of a rapidly changing communications marketplace, it is vital that small printers be able to continually modernize their product and service offerings. When I say I am in the printing business, I am often asked if the Internet is killing off our profits. People are surprised to hear it is quite the opposite; there are tremendous growth opportunities in combining old school ink-on-paper printing with online and social media technologies. But it takes serious capital investment in order for small printers to evolve.

For example, in 2012, Linemark had purchases over $2.5 million. This included a $2.2 million printing press, a $174,000 router system, an $82,000 laminator, and a new $17,000 VOIP phone system. By utilizing bonus depreciation, we did have an incentive and the additional resources to make the investments in our company's future growth. In the future, we will be upgrading our digital printing presses, which is the predicted growth area in the printing industry, and we will be adding new large format printers and expanding our bindery functions—both of which will allow Linemark to better compete in ancillary services that are critical to staying live in the new print marketplace.

Small printers would benefit in their ability to grow if section 179 expensing was made permanent. The typical printer plans on spending $50,000 to $100,000 on capital equipment this year. Generally, higher profit printers are more likely to invest in capital equipment and to invest higher amounts than lower profit printers. These profit-leading printers are most likely to create new jobs. The impact is also positive for small suppliers that manufacture printing equipment, many of which are members of the Printing and Graphics Association of the Mid-Atlantic and the Printing Industries of America.

The second is the provision that would simplify and expand the use of cash accounting for small business. The typical printing plant is small with around $3.3 million in annual sales and 20 employees. Many of these small firms would find new cash accounting rules helpful as Linemark would have when it was smaller. However, I should note that with this proposal, C corporations with gross receipts up to $10 million would gain the option of using cash accounting, but larger S corporations would lose it. More than 800 printing plants are S corporations and would fall into this category.

Finally, the discussion draft poses two options to reform the rules for small business organized as partnerships and S corporations. Approximately, 20 percent of the industry is comprised of sole proprietorships and partnerships. Another 5 in 10 printing firms are organized as S corporations. Linemark is a C corporation, but we do recognize that many other printing companies use the S corporation to simplify their structures.

I would also like to briefly mention estate tax. The new exemption levels passed by Congress early this year are very helpful to companies like Linemark as I prepare for my children currently working with me to hopefully stay with the family business in the future.

In conclusion, I urge this Committee and all Members of Congress to continue this important dialogue, maintain a strong focus on how the comprehensive tax reform legislation will impact America's small printers and small businesses in all industries.

Thank you. And I look forward to answering any questions you may have.

Ms. VELÁZQUEZ. Mr. Chairman, it is my pleasure to introduce Mr. Tim Watters. Mr. Watters is the president and CEO of Hoffman Equipment Company located in New Jersey. The company was started in 1920 as the Hoffman Motor Transportation to deliver roofing material for installers, and it has been expanding ever since. Mr. Watters represents the third generation to run the business. He is testifying on behalf of the Associated Equipment Distributors, which represents over 500 distributor member companies. Welcome.

STATEMENT OF TIMOTHY WATTERS

Mr. WATTERS. Good afternoon, and thank you, Chairman Graves and Ranking Member Velázquez for organizing this important hearing and for inviting AED to participate. I also want to thank Chairman Camp for making tax reform a priority and for the transparent process he is created to gather the best ideas about how to improve the code. AED is looking forward to working with him and with all of you to achieve the objectives in the weeks and months ahead.

AED's members are family-owned companies, like mine, that sell, rent, and service construction, energy, mining, forestry, and farm equipment. We are the critical link between machinery manufacturers and the local highway contractor, home builder, and farmer, and others who put equipment to productive use.

The equipment industry is dominated by closely-held, pass-through entities. Two-thirds of our entities are S Corps, LLCs, or LLPs. The average AED member who organizes a partnership has fewer than three owners. For that reason, we believe business tax reform should not only benefit big publicly-traded corporations. Tax laws affecting smaller companies and pass-through entities must be improved as well.

It is AED's position that tax reform should focus on two broad objectives. First, simplifying the code the reduce compliance costs and unintended consequences. And second, restoring long-term certainty to allow businesses and individuals to better plan for the future. The code's complexity has driven compliance costs through the roof. In fact, the IRS itself estimates that Americans collectively spend 6 billion hours per year on tax compliance, the equivalent of 3 million full-time jobs. Indeed, the code has grown so unwieldy that Congress cannot change it without negative unintended consequences.

Let me give you an example specific to my industry. The Affordable Care Act established a new 3.8 percent tax on unearned in-

vestment income, which took effect January 1st of this year. The purpose of this new tax was to ensure that individuals who derive their income from passive sources, like stocks and beach houses, would not be able to avoid paying Medicare taxes. Unfortunately, the bill's drafters did not foresee the impact the law would have on legitimate, active construction equipment companies like my own. The people who wrote the bill certainly knew the tax code generally treats rental income as passive income but they did not consider that over the past 25 years there have been significant shifts in the construction industry towards the renting of construction equipment. This trend has accelerated in recent years as a weakened economy and uncertainty surrounding government infrastructure programs have made contractors more hesitant to buy new equipment. So despite the fact that this rental money is being earned by brick and mortar companies like my own that actively employ close to 47,000 people, the revenue is considered passive and it is therefore subject to the new 3.8 percent tax, which in our own case will result in an approximately $400,000 tax increase.

Basically, we have become entangled in the complex web that is the U.S. tax code and find ourselves ensnared by the new tax law we were never meant to pay. Not surprisingly, one of our top reform priorities is working to resolve this issue and we would of course appreciate any support this Committee can give.

As I mentioned earlier, restoring certainty should be the second guiding priority for tax reform. Ninety-six percent of our members agree or strongly agree that the uncertainty surrounding the tax code is undermining the nation's economic vitality. Certainty means many things. It means making the good parts of the code permanent and ending the practice of having so many provisions like higher section 179 small business expensing levels expire on an annual basis. It means establishing a permanent tax code so we know that the things we are doing today and have been doing for years, like using "last in, first out" accounting method and deducting business interest are going to be permissible not just a year from now but a decade from now as well.

In conclusion, tax reform should be fair, encourage business risk taking and investment, and everyone should share in the benefits. AED and its members look forward to working with Congress to achieve these objectives. Thank you again for the opportunity to testify today and I am looking forward to any questions.

Chairman GRAVES. Thank you very much, Mr. Watters.

Our next witness is Roger Harris, President and CEO of Padgett Business Services in Athens, Georgia. He has been with Padgett for more than 40 years. After serving as president of its largest franchise in the organization he became president of the entire franchise system in 1992. He has served twice as chairman of the Internal Revenue Advisory Council and has been called to testify numerous times before both houses of Congress on small businesses, IRS, and tax issues. Thank you for being here, and I look forward to your testimony.

STATEMENT OF ROGER HARRIS

Mr. HARRIS. Thank you, Chairman Graves and Ranking Member Velázquez. It is a pleasure to be here. Thank you for the opportunity.

Padgett Business Services has been providing accounting, tax planning, tax preparation, and payroll services to small businesses for, as we said, almost 50 years. We define our customer as one with fewer than 20 employees. And to some people they consider those to be "mom and pop" businesses. However, when you look at them collectively, I think the last study I saw said that that group of people employs 90 percent of the workforce, so we think individually they may not be that large but collectively they are a powerful organization.

The other interesting thing I think as I listen to my panel colleague and other small business owners is someone once told me that being a small business owner was the opportunity to do the one thing that you love and the 99 things that you hate. And probably the top two things on the 99 list would be paying taxes and tax compliance. And so anything that we can do to simplify our small business owners' lives would be welcome by then. And quite honestly as we sit here on April the 10th, five days from the filing season, I can assure you despite the comments that have been made about firms like ours benefitting from tax reform, we would be very happy to see a little simpler and more predictable tax system going forward. So we want to thank this Committee and, of course, Chairman Camp and his Committee for the work that they are doing and all of you are doing to simplify the tax code.

We are particularly excited about the expansion of the cash method of accounting because for our marketplace that would make their lives terribly simpler because one thing they do understand is their checkbook. They understand when money comes in it should be income and when money goes out it should be an expense. And the closer we can stay to that method of accounting, the better it will be for all of us, so we are particularly pleased to see that included in Chairman Camp's proposal. We have, in fact, been trying to push that along with David Kautter from American University. In fact, we are a little more aggressive than Chairman Camp is, so we hope you would consider some of our ideas to even expand that. But we are particularly pleased to hear that that is a big part of what tax reform could look like.

We are also happy to see the discussion on the business structuring part of small business because, you know, in many instances a lot of people assume, particularly in our marketplace, that people got to where they are through a lot of planning and taking advantage of how the tax code helps them. Really in our marketplace it does not work that way, and I would like to illustrate that by telling a short story. And that is that one day you are cutting your grass and the IRS views that as a hobby. The next day when your neighbor needs you to cut their grass. You became a sole proprietor. When more neighbors needed their grass cut you called your friend with his lawnmower and they came and helped her, you became a partnership. And then later on you talked to someone like us or an attorney and you became an S Corp or an LLC. All through that process your life got more and more complicated, but

to the business owners they are still just cutting grass. And that is what they want to do and that is what they want to spend time doing so they can cut more yards and hire more people and do more things, and less time complying with a complicated tax system.

So tax reform is very much needed for small business, for people like us. We are a big supporter of what the chairman and his bill proposes. Like anything, we have some ideas that we would like to see a little differently. We are a little concerned in one of the proposals about entity level withholding on income because that requires there to be a calculation of income that may or may not exist, and so we think perhaps we could do something with entity level withholding on payments that might work better. But again, this is a great step.

I echo the comments of everyone. Predictability was a huge part of the problem we face today and anything we can do to make small businesses' life simpler we would all welcome it. I think we all recognize there is a compliance burden that has to be met but we have to be careful that that burden does not get into something beyond what it is intended to. And as we have heard here there can be unintended consequences that take away from that business owner focusing on that thing that got them in business in the first place because they can help this economy grow. Again, small businesses may not hire 100 people at a time but there are so many of them. If they could all just hire one new person over the next 12 months this country would be a whole lot better for that. So anything we can do. And again, I want to applaud the work of Chairman Camp and his Committee, and this Committee particularly, and I look forward to the opportunity of taking your questions. Thank you again for the opportunity to be here today.

Chairman GRAVES. Absolutely. And thank you all for participating. We are now going to move into questions. And I do want to remind the Committee, too, that if anybody has any questions for Chairman Camp, just submit them and he will be happy to get those answered.

We are going to start out with Mr. Hanna.

Mr. HANNA. Thank you, Chairman.

I have a question that may sound like a philosophical question but it is not. One of the conversations that goes on around this place a lot is what wealth is, what wealth means, what the accumulation of wealth, and how much of that wealth that you accumulate is the government supposed to take away from you. I have always maintained that being in small business, while we all want to make money, it is hard to grow your business if the government does not let you retain things because we all live in cyclical businesses, like even Mr. Watters, up and down, you do not know from year to year what you are going to do. And in a very real way it is hard to run a secure business unless you are allowed to retain your earnings. And if we are taxing you at a rate of 44 percent as Mr. Camp said, then add your state rates to that and then you have to live off of it, my point is a quarter of a million dollars a year may sound like a lot of money to a lot of people but I would like your view of what that means to you in terms of growing your business and hiring people, and how you view that kind of wealth

in terms of your ability to raise your family and run your life and still grow. If that is not too abstract.

Mr. WATTERS. Are you asking me specifically?

Mr. HANNA. Yes, sir. Or anyone, really.

Mr. WATTERS. Well, I will take a stab at it.

Yeah. The cost of running a business is extraordinary and seems to grow all the time and from all angles, and it is really a very difficult world to operate a business. And in many regards $250,000 is a lot of money and there are a lot of people and our own employees that do not earn anywhere near that much. And you wonder in today's economy how they make it quite frankly.

But in terms of operating a business, you know, it is a drop in the bucket. It is not a lot of money at all in terms of the various expenses they face on a day-to-day basis for sure.

Mr. HANNA. Mr. Griffith?

Mr. GRIFFITH. Well, you have a good point there when you said 44 percent to the federal and then you pay the state. That is about 50 percent of your money that goes away. That is a huge silent partner out there that is taking no risk. You know, we are taking all the risk of the business and we have got 50 percent left that we invest in our business and live off that money, and that is very difficult. Two hundred fifty thousand dollars when you are a pass-through entity, you can get to that number very quickly. And also when you have two wage earners you can get to that number very quickly. And I think that is a pretty low number to say that it is a wealthy person.

Mr. HANNA. Mr. Bearden.

Mr. BEARDEN. I would agree with these gentlemen. Our business is very cyclical, so when we have good times we do need to put away some money for times that are not as good. And that happens. We went through a very steep drop in 2009 with our own business and we were very fortunate to make it through there but it got very, very tight. And through the better years if we had been able to keep a little bit more money in the business it would have helped out.

Mr. HARRIS. Just to add to what others have said, and I will come back to the cash method of accounting again, it is one thing to owe taxes on money that you have earned; it is another thing to owe taxes on money that showed up on a piece of paper that you did not have. So I think what is critically important is whatever our tax rates are that it be based on the real money that the company generated, not some fabricated number due to some complicated tax law or accounting trick.

Mr. HANNA. So you would like the accrual method to be an option and cash method to be an option also. You are at—what is it, 5 million now, so you raise it to 10.

Mr. HARRIS. Ten. We would think that for the—and again, everything has got to have exceptions for certain things but for the most part, the closer we can allow businesses to track their cash inflows and outflows and let that be the determining factor of how much tax they owe, not that they will ever like paying taxes but at least it will be a little bit more understandable and a little more bearable because it will be based on the real money that they generated.

Mr. HANNA. Mr. Griffith, if I have a moment left I want to ask you something. You said that you put off making certain decisions based on the uncertainty of the tax code. If you could clarify that. I would assume that that means that you buy what you need regardless of the tax code but the uncertainty changes kind of the dynamic and makes it harder to think about?

Mr. GRIFFITH. Right. All your decisions are investments and are not necessarily affected just by taxes. But you have to have the cash to buy this equipment. And when you are sitting there and you see this deduction go away if you purchase too much in that year, then all of a sudden you have got less cash to put into that piece of equipment and it might make the decision of whether you can afford to buy it or not. And that is basically what I was getting at.

Mr. HANNA. Thank you. I have no further questions. Thank you, Chairman.

Chairman GRAVES. Thank you, Mr. Hanna.

Ms. VELÁZQUEZ. Mr. Watters, there is much talk about repealing certain tax provisions that are vital to small businesses, such as the AMT and the estate tax. However, there is a reluctance to have these taxes paid for which builds upon our national debt and further reduces the investment that can be made for transportation or infrastructure. Higher taxes do burden businesses but in order to control national debt also stifles overall growth in our economy. How do we strike an appropriate balance between the need for businesses to have lower taxes and keeping our government fiscally responsible?

Mr. WATTERS. And I guess that is the million dollar question. And I wish I had the answer to that. And I do not think I have the answer but I do have some thoughts on that, some themes.

Ms. VELÁZQUEZ. Nor do we.

Mr. WATTERS. So I think that the end of simplifying the tax code and creating certainty to the tax code is an end worthwhile in and of itself, irrespective of whether the changes are tax neutral or create tax revenue. I think that end is worthwhile and will benefit the economy, and ultimately will indirectly produce more revenue for the government down the road because of having greater certainty and businesses are doing better.

In addition to that though, you know, we are very much in favor of any tax that would be directed towards infrastructure investment. We feel that investment in our infrastructure, which is in serious decay, is ultimately beneficial to the economy and we would actually be proponents of user fees, either increased gas taxes or miles driven taxes, that would be earmarked towards infrastructure investment, particularly our highways and bridges.

Ms. VELÁZQUEZ. Thank you.

Mr. WATTERS. Thank you.

Ms. VELÁZQUEZ. Mr. Harris, the current tax code contains sections using various definitions of a small business, either using gross receipts or number of employees. Some experts have suggested that using only one definition for a small business will make the tax code simpler. How could the use of a single definition help or hurt small businesses if this is an approach that should be considered as we move forward with tax reform?

Mr. HARRIS. Well, you are right. There are as many definitions of a small business. Depending on who you talk to they can all come up with a different one. We focused on employees because we thought gross receipts as a definition probably had more to do with what you sold than anything. Like, if you are selling Cadillacs it is going to be easier to get to 10 million than if you are selling candy bars. And so we looked at employees as a measure of complexity in what we thought a small business should be and we thought if you have one employee it cannot be too complicated, and if you have 100, it cannot be too simple. But I am not sure there is a perfect definition of small business. Maybe it would be good to at least agree on what it is, whatever that is. But I think we can all make a strong case for whatever we want it to be.

Ms. VELÁZQUEZ. Mr. Bearden, there are a variety of business classifications that entrepreneurs can choose from when incorporating their firm. How do you choose your business entity classification? And what advantages does that form offer that the other structures do not?

Mr. BEARDEN. Our company was started as a C corporation before I actually became the owner of the company, so we carried that on. Now what we would look at were the tax structure as far as being a pass-through or being a separate entity. And there are various advantages and disadvantages to it either way. If we go to sell the company as a C corporation we could run into an issue of double taxation. We cannot take dividends out of our company without paying taxes on them twice.

Ms. VELÁZQUEZ. So depending on how the tax reform is implemented, will you consider changing your classification?

Mr. BEARDEN. We were considering changing just a couple years ago but now with the latest changes in the income tax law it is actually more expensive for us if we were an S corporation than a C corporation. So we are kind of stuck between are we trying to get a better tax advantage for when we sell? Or are we trying to get a better tax advantage right now as we run the business?

Ms. VELÁZQUEZ. Mr. Harris, the small business tax reform proposal will make numerous changes to the S corporation rules. The draft contains two options for pass-through entities. One of them keeps the current system and the other starts fresh. Is there a balance that can be struck between making changes to the S corporation rules while keeping an entity classification that caters to the small family-owned businesses?

Mr. HARRIS. Oh, sure. I think there can. I think as a general rule we supported what I think was option one in Chairman Camp's white paper because it was a little easier to understand. It was more of a transition than a radical change. And again, in any of these instances there can be pluses and minuses. What I find interesting when we talk about entity classifications is in many instances what the small business owner wants is the entity that gives them the most protection from a legal standpoint that comes with the least burden of recordkeeping. And sometimes one drives the other.

And to the comment made earlier, with the changing of the tax law you think you have picked the right entity and then the next time you turn around you need to change because the law has

changed and now you are trying to go back and forth. So consistency would help tremendously. But I think, I do not know, maybe it is just that I have done this long enough, tinkering with the option one feels to me a little bit more than just a radical change and trying to understand what that transition would look like.

Ms. VELÁZQUEZ. Okay. Thank you. Thank you, Mr. Chairman.

Chairman GRAVES. Mr. Bentivolio.

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

Mr. Griffith, I think you said you are a CPA and you own a machine or tool and die company; correct?

Mr. GRIFFITH. Yes.

Mr. BENTIVOLIO. Now, let us see if I understand this right. Section 179, $500,000, if you purchase equipment you get a deduction; right? Is that right?

Mr. GRIFFITH. Yes, sir.

Mr. BENTIVOLIO. So the cost of this C&C machine?

Mr. GRIFFITH. $611,000 machine.

Mr. BENTIVOLIO. I think I read that in your testimony. There are more expensive ones, is there not?

Mr. GRIFFITH. Oh, yes.

Mr. BENTIVOLIO. And a small business can buy a 40-ton stamping press?

Mr. GRIFFITH. Oh, yes.

Mr. BENTIVOLIO. Do you have any idea how much those cost?

Mr. GRIFFITH. Not off the top of my head but I would think they can range anywhere from probably in the hundreds of thousands to a million dollars.

Mr. BENTIVOLIO. Over a million.

Mr. GRIFFITH. It depends on the complexity of the machine and type.

Mr. BENTIVOLIO. As well as the dye.

Mr. GRIFFITH. Yes.

Mr. BENTIVOLIO. You know, the dye can cause——

Mr. GRIFFITH. Absolutely.

Mr. BENTIVOLIO. And you need that die in order to stamp, to make a product that adds to, well, productivity.

Mr. GRIFFITH. Right.

Mr. BENTIVOLIO. Manufacturing.

Mr. GRIFFITH. Right.

Mr. BENTIVOLIO. Mr. Bearden, you said that a press, printing press can range, well, I bought one for $300 for my office, right? And they can go—commercial grade can cost——

Mr. BEARDEN. You could go to $3 or $4 or $5 million.

Mr. BENTIVOLIO. So this $500,000 deduction would not really, if you bought something like that, would not really make a difference, would it?

Mr. BEARDEN. Well, not if I was buying a printing press.

Mr. BENTIVOLIO. Right. Or, well, the printing. I do not know—do they call them presses now or are they just——

Mr. BEARDEN. Yeah. They still have printing presses.

Mr. BENTIVOLIO. Yeah, okay. Good. I know things have changed.

Let us see. You touched on concept, Mr. Griffith? You touched on a concept not often talked about in your written testimony, how

your tax liability impacts your ability to obtain financing. Could you expand a little on this issue?

Mr. GRIFFITH. Well, yes. When you have to use your cash to pay your taxes, it leaves you a lot less capital to invest in the business. And so when you go out to borrow money they look at your liabilities, they look at your assets, and they determine whether or not you can repay the loan. And so the more cash that goes out the door for a nonrecurring asset or something that is a debt expense like that, the less you have to work with the more difficult it is to get the financing.

Mr. BENTIVOLIO. And you noted in your written testimony, and I think I touched on this, written testimony that Congress passed a provision increasing the deduction allowance under section 179 to 500,000 and increased the phase-out provision to 2 million. But that was done on December 30th of last year, giving a business no time to act. That is what you said; right?

Mr. GRIFFITH. Yes, sir.

Mr. BENTIVOLIO. So we had to move, for instance, if I bought a 40-ton press, I mean, they can be about, what, a third the size of this room?

Mr. GRIFFITH. Right.

Mr. BENTIVOLIO. It weighs more than an Abrams tank; does it not?

Mr. GRIFFITH. Yes. And you cannot, you know, and the rule was you have to be placed in service, which means it has to be under power, ready to run. These are not plug-and-play machines.

Mr. BENTIVOLIO. I understand.

Mr. GRIFFITH. So in a day you could not react to that. That is correct.

Mr. BENTIVOLIO. I was raised in manufacturing. I know exactly what you are talking about.

So what would you recommend?

Mr. GRIFFITH. Well——

Mr. BENTIVOLIO. I want to get people back in my district working again. I am sick and tired of driving by industrial parks that say For Rent, For Lease, and Available. I like to see Help Wanted signs. So what can I do? Or what can we do? What would you recommend to Chairman Camp?

Mr. GRIFFITH. Make it permanent so that we—in other words, set the 179 deduction and stay at $500,000. Raise the limit to more than $2 million. In other words, you know, do not phase it out at a low level and make it permanent so that we know year in, year out, what we are working with as opposed to one year—it used to be $25,000 and then it went to $125, and then it went to $500,000. Then last year it was $139,000 with a phase out over $560. So if I bought it a $600,000 machine and it phased out the deduction to me, make it such that we can actually get this deduction when we do buy this equipment because when we buy a piece of equipment like you are talking about—a stamping press or in my case it was a tool grinding machine, I have to hire a person to run it. So not only do I add equipment to my shop, I add employment. So by not buying that piece of equipment I did not hire that person. So, you know, I think if you can make it permanent so we know what we

are working with and it is not a moving target and it is not changing every year, it makes it a lot easier to manage.

Mr. BENTIVOLIO. And I could buy, like, well, a small business could buy a 3 million C&C machine and have five people in the shop. Be actually employing five people; correct?

Mr. GRIFFITH. Correct.

Mr. BENTIVOLIO. Right. Great. Thank you very much.

I yield back my time, Mr. Chairman. Thank you.

Chairman GRAVES. My good friend, Mr. Barber.

Mr. BARBER. Well, thank you, Mr. Chairman. Thank you to the witnesses. You provide us with real life accounts of what it is like to run a small business, and I appreciate that testimony very much. We need more of it on the Hill, I think.

My wife and I ran a small business for 22 years and we have our own first-hand accounts of what it is like to meet the tax code challenges and the other regulatory challenges. And I am really proud to be on this Committee. I am a new member of the Committee. I asked to come on as a third Committee because I really wanted to do what I could to help small businesses not only back home but across the country.

And I want to venture into an area that has not really been discussed today but I think is one that is really important as we think about simplification of the code, we always have to think about new taxes that have been imposed. You mentioned one or two of them earlier, the Affordable Care Act being one of the examples.

Back home in my district we have a business called Syncardia. It manufactures the first and only FDA-approved total artificial heart, and it took Syncardia about 30 years to get where they are today, one small investment at a time. And now they are cash flow positive, they are paying taxes, and they are saving hundreds of lives every year. But one of the issues that they face and other businesses like them face are taxes that stifle innovation, creativity. One example of that is a tax that is now included in the Affordable Care Act, the medical device tax, a $20 billion tax that is going to be levied on total revenues of medical device manufacturers beginning this year. And for companies like Syncardia and many others across the country, the impact of this tax would be devastating to their future innovation and success. It is a tax I believe we must eliminate and I co-sponsored a bipartisan bill called the Protect Medical Innovation Act to do away with that tax.

So this is one example, I think, of taxes that stifle creativity and innovation, and one of the great things about our country is that small businesses are the leaders in creativity, and they really, of course, drive our economy. So it is really a question for any and all of the witnesses who want to comment. Could you comment on what other taxes we ought to be looking at as we simplify the code or want to do that that are hurting small businesses, specifically when it comes to innovation? New ideas, new products, new kinds of assistance for people in the medical arena and every other place. I mean, I think we have them across this country. And could you each comment to your own experience on what other taxes are getting in the way of innovation?

I thought Mr. Harris might be the first to jump in.

Mr. HARRIS. I will go first, which will be a more general comment than specific to an industry that these gentlemen can speak to, is that I do not think anybody in this room likes paying taxes and would like to pay less, but what they want to know is they want to understand what they owe, be able to plan for what they owe. Clearly something like the Alternative Minimum Tax that traps people who tried to do the best they could and tried to plan and then they have this second tax level pop up and surprise them. So I think transparency in taxes, predictability in taxes, and not being picked on because you are in a certain industry or doing a certain thing. I think that as long as people feel like they are paying equally and they are all bearing the responsibility, but any time we target a particular business and say you are going to pay something I think it obviously leads to higher noncompliance because they are going to go "why me?" Why is it not someone else?

Mr. BARBER. The issue of the medical device tax was first brought to my attention by a dentist in my district. He wanted to come see me and he said, "I need to talk to you about this." He said, "It is not only going to affect my business but my patients. They have to pick up additional costs." And this is why I am really concerned about how this might affect other industries. Any other comments from any of the other witnesses?

Mr. BEARDEN. I would just say commercial printers are domestic manufacturers, and we qualify for the 9 percent deduction in our net income. And I would encourage the Committee to incorporate the domestic production activities deduction in their small business reform. That is something that is very helpful for us and I would agree with the other gentlemen. Just stabilizing and simplifying the taxes would help out tremendously.

Mr. BARBER. Very good.

Mr. GRIFFITH. You know, the complexity is a tough issue because you give us credits and then you take them away because of AMT. And that is one of the things I mentioned earlier, and the Alternative Minimum Tax, we need to get rid of that. We need to fix that because it is something that is hanging out there and the complexity—let us say if we bought assets in my business and I have let us say 1,000 assets. I have to do depreciation calculation for federal tax purposes. I do a depreciation calculation for state tax purposes because Maryland decoupled from federal. I have to do depreciation calculation for AMT purposes. And then I have generally accepted accounting principles, which is GAAP. I have to calculate depreciation four times on the same asset. That is a lot of work and a lot of busy work for no reason. So why are we not trying to look at simplifying and getting rid of some of the complexity so that we know what we are working with and it does not take a lot of time and effort away from our businesses to comply with these kind of rules.

Mr. BARBER. Thank you, Mr. Chairman.

Chairman GRAVES. Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Mr. Chairman. And thank all of you for being here today. It is always near and dear to my heart when I see small business guys in front of us.

Just quickly, I did not see anything in the testimony and in the recommendations and information that Congressman Camp gave

us today with regards to intellectual property. Do any of you have intellectual property and have some tax concerns about that? Probably Mr. Griffith may be the only one that actually would have something there. I do not know if you do or not, but just kind of curious if there is something in that area because it was not mentioned in Mr. Camp's testimony if we need to look at something like that.

Mr. GRIFFITH. We do not. We do not have any intellectual property in our business.

Mr. LUETKEMEYER. One of the other things I noticed, Mr. Bearden, you indicated or mentioned anyway that you support estate tax changes that were made earlier. And I was just kind of curious if there is any changes or anything else that you would like to see done differently with the state taxes and how it impacted you and your business. Perhaps a little firsthand anecdote here would be informational to us as a body.

Mr. BEARDEN. Well, just as the business hopefully grows, knowing that I can plan for that in the future and that it is permanent now is very helpful. Under the other rules when it was running out it was kind of up in the air. We did not know where we would be. You almost had to pick your time, I guess, but going forward now that it is permanent it is much better and it is very helpful. Thank you.

Mr. LUETKEMEYER. Mr. Harris, a lot of your customers and your clients, was this an issue big to them? And do you see any things that we need to tweak on this law as well?

Mr. HARRIS. I think, again, as everyone has said, what they needed to know is what is the law?

Mr. LUETKEMEYER. Does the company see uncertainty?

Mr. HARRIS. Yeah. The moving and changing levels, I mean, it made planning impossible because, again, you had better years to die than others, which is not the way we want, you know, our tax code to push people. So consistency and predictability, I will keep coming back to that, is the key thing.

Mr. LUETKEMEYER. Very good.

It did not lend itself to a good business model, a good business planning, did it? In a management crisis you realize that, right?

One of the things that is coming up shortly here that we will be discussing when we talk about revamping the tax code is perhaps doing away with some of the deductions that are in there and then on a revenue neutral basis lowering the tax rates and things like that. Are there some things in there, in the tax code that you would like to—that you would be willing to give up so that you could get a lower tax rate? Is there something there that would entice you to be interested in doing? It is going to be a hot button issue. I thought maybe you guys would like to jump in on it.

Mr. HARRIS. Generally, we have to understand from a business standpoint that the calculation of taxes has two elements—the rate and what we are applying the rate to. And at the end of the day if those two numbers are moving equally, the amount you write the check for does not change. So anything that is simpler and easier to get to, small business would appreciate. And then we can argue about what the proper rate is at that point. But we do not even know. It takes so long to come up with a number, by the time we

get there the rate is almost a secondary discussion. So I would like to see us focus on yes, there are plenty of things that we can get rid of; the problem with getting rid of them is we do not know what the rate is going to be applied to when we give it up. And at the end of the day, if you do not know both sides of the equation, it is hard to say I am for this or for that because I do not know what I am giving up and what I am getting in return. But as a general rule. Sure. Make it simpler and hopefully the rates will not cause it to go up.

Mr. LUETKEMEYER. Does anybody else want to weigh in on it? Yes, sir. Mr. Watters.

Mr. WATTERS. I would like to weigh in on that.

As Mr. Harris says, it is hard to say what we are willing to give up without knowing what the rate would be.

Mr. LUETKEMEYER. Well, let us assume it goes down. We are not going to raise it. Okay? Let us assume that if you take your deduction you are going to lower the rate from 35 down to whatever it gets down to.

Mr. WATTERS. We absolutely think that restoring the highway trust fund to a reasonable level of investment is absolutely a worthwhile goal and should be part of any tax reform, and we would be willing to give up user fees and other types of things along that line to fund the highway trust fund for sure.

Mr. LUETKEMEYER. Okay. Excellent.

Did you guys want to weigh in on it?

Mr. GRIFFITH. I do not know really what I would like to give up but I would like to give you a radical opinion on one thing, and that is I would like to see you abolish the inheritance tax. Just get rid of it because, you know, you have to sell the farm. If you ever saw the movie "Secretariat." The horse won the race and now all of a sudden it is worth $6 million and she had to syndicate, practically sell the horse to save the farm. That is criminal. And I think that we should just abolish the darn thing.

As far as what I would give up, I would have to see the balance. I would like to see what is going on and what you are arriving at before I start giving up anything and see where we are going with everything because it seems like we do not have a revenue problem in this country; we have a spending problem, sir. I think you know that. And I think everyone else here knows that. And we need to look at where our monies are going and not really what we are doing with our expenses as much as we do revenue. I am talking about any business is faced with that and the government certainly should be faced with that.

Mr. LUETKEMEYER. Very good.

Mr. Bearden, do you want to weigh in on it? Okay.

I see my time is up and I certainly appreciate all of you being here today. As a small business owner myself I know that you did build it. Thank you. Thank you, Mr. Chairman.

Chairman GRAVES. Mr. Payne.

Mr. PAYNE. Thank you, Mr. Chairman.

Good afternoon, gentlemen. It has really been interesting to listen to your testimony.

Mr. Bearden, we share a vocation. I was a printer by trade. My uncle started a computer forms manufacturing firm in 1969 and

ran up against quite a few challenges being the only minority firm in the United States doing what we were doing at that time. And had to overcome many obstacles. Some were biased and problems with him being the only minority in the field and overcame many challenges at that time. But, you know, from one printer to another it is good to see you here.

Mr. BEARDEN. Thank you.

Mr. PAYNE. Let me say in Mr. Watters's prepared testimony, you know, he stated that his members agree that balancing the federal budget requires spending cuts naturally, entitlement reform, and tax increases. How does the rest of the panel feel and what are your sentiments, Mr. Griffith?

Mr. GRIFFITH. I think that definitely we need to look at tax reform and make it, you know, as we said before, make it simpler and balance the budget is very important. I think any business, any company, any government should balance budgets. And deficit spending does not work and where we are basically leveraging our children's future and our grandchildren's future when we do that type thing. So I think we really need to take a look at when you increase revenues—when you increase taxes rather I think the model that has been seen in the past is that the economy goes down and the government has less money to spend. When you reduce taxes oddly enough the economy grows and the government has more money to work with. I think you really need to take a look at that. I do not think tax increases is going to necessarily bring you more revenue. But I do believe that you need to take a look at a balanced approach, and that is, you know, what is revenue neutral, we need to get back to the old school of balancing a budget in all of our businesses. I certainly could not survive—deficit spending. And I think that is something we need to take a look at.

Mr. PAYNE. Mr. Bearden?

Mr. BEARDEN. One of the things I think would just help us in what we are looking at is just the simplification of the code and making the changes permanent. And that way we can do longer range planning. Right now some of the things that we have talked about here today, I mean, there are times, last year, for instance, when we did not know whether we were going to have bonus depreciation until the end of the year. So all during the year we really could not make any plans to use that. If those things are set and they are permanent, we can react from our business and that can be a positive factor to help us invest quicker and make quicker decisions. There is also a lot of time that we have to spend as business owners trying to learn the tax code and to keep up with our accountants and our CPAs. What is happening right now? What is going to happen six months from now? It is not three years out. It is on a weekly-monthly basis on what we are doing today. So just the simplification and making that permanent would help out tremendously.

Mr. PAYNE. Mr. Harris.

Mr. HARRIS. Well, I think everyone would like to see the federal government's budget come to balance. I am not going to sit here and say I am smart enough to tell you exactly how to do that. It is a lot smarter than me. I have not figured it out quite yet.

I would say this. I think that the way that I would prefer to see there be more revenue raised would be that the small businesses are paying more taxes because they are making more money as opposed to taking more of what they are making today. So I think if we can have them grow and expand then I think they would be happy to pay in more revenue to the government through that method.

Mr. PAYNE. And, you know, Mr. Harris, you know, you detailed a proposal that, you know, since we are talking about making it easier and knowing, you know, what—keeping things in place, you know, your simplified cash method that you discuss, and under this method a business checking account would be essentially their books for a small business. Can any of the panelists speak to the benefit of such a method, that simple a method and any potential challenges with that and/or benefits?

Mr. Griffith.

Mr. GRIFFITH. Yeah. I guess it would definitely simplify for small business when you are dealing with a cash basis because as Mr. Harris has stated it is cash in and then expenses out. You can see where the money is coming and where it is going. You get rid of all of the transactions and you have to record—you have to book payables, you have to book accruals, or you have to depreciate assets and that type thing. When you know when you purchase it you expense it. And I guess it would maybe simplify considerable businesses on a certain size. And again, as we were talking earlier, how do you determine that size? But I think that it would have some merit for a small business.

Mr. PAYNE. Mr. Bearden.

Mr. BEARDEN. I would agree. It is simpler for a small business to use the cash accounting. Even in our business, for our internal statements we use cash accounting to look at how the business is operating. It is very important for the business to understand its cash flows and things like that and cash accounting takes you pretty close to that.

Mr. PAYNE. Mr. Watters.

Mr. WATTERS. Yeah. I agree as well. I think it is a great idea and would simplify things significantly for smaller businesses. Our business volume exceeds the cutoff so it would impact us directly, but it seems like a great idea to me for sure.

Mr. PAYNE. Thank you. Thank you very much.

Chairman GRAVES. Mr. Huelskamp.

Mr. HUELSKAMP. Thank you, Mr. Chairman. Gentlemen, I appreciate your presence.

A very broad question. A couple different themes we have heard here today. Obviously, one would be tax simplification as well as tax certainty. A pretty broad question to each one of you. Which of those would you consider most important and why between those two? I do not consider them separately but generally they are discussed separately around here as two different goals.

Mr. Griffith.

Mr. GRIFFITH. Well, definitely simplification is needed, and I would probably lean towards that direction. However, again, uncertainty is hard to play if you do not know how the law is going to react given in the future. In other words, if I make a decision

today, what impact will it have on me 10 years from now? Will it still be the same decision and am I still in the same place? That does make it difficult, but I think the complexity of the issue you are dealing with on a day-to-day basis is probably something I would look more for as of right now.

Mr. HUELSKAMP. The gentleman, Mr. Watters.

Mr. WATTERS. Sure. Actually, I would disagree. They are both critical topics and we want both but I would rather have a complex law but that I know is going to be in place for many years and I can plan around and I will figure out a way to figure it out. I would have to hire a gentleman like Mr. Harris here to figure it out, but at least you have something you can plan around and make investment decisions around as opposed to having a simple law that is going to change every December 30th and you never know what you are going to get the following year.

Mr. HUELSKAMP. How long would you need for certainty? How many years in your business? What are you looking at?

Mr. WATTERS. Ten years. A generation. Always. Start with 10.

Mr. HUELSKAMP. Mr. Harris? Mr. Bearden?

Mr. BEARDEN. I would agree with Mr. Watters. I think for our planning purposes certainty would be better. If it is complex we can figure that out and know what we are dealing with, but as long as we know what we are dealing with for some length of time we can plan properly. And so definitely certainty in my case.

Mr. HUELSKAMP. Okay.

Mr. HARRIS. Well, I guess I am either going to break the tie or tie it up here.

I think first of all for it to be simple it has to have a certain element of certainty to it. I mean, if it is just simple and it can change tomorrow, it is not really simple. If I had to pick between the two, I guess I would pick certainty because one thing I have learned in this many years of doing this is complexity does not bother people near as much when it makes their taxes go down as when it makes their taxes go up. So there is some complexity people will accept because it helps them. So I guess I would pick certainty, but I am just not sure I could be simple if it is not certain.

Mr. HUELSKAMP. Well, thank you, gentlemen. I appreciate that. I yield back. Mr. Chairman.

Chairman GRAVES. Ms. Clarke.

Ms. CLARKE. Thank you, Chairman Graves, Ranking Member Velázquez, gentlemen.

I have a simple question. We talked a lot today about the whole idea of simplifying the tax code, especially with regard to our nation's small businesses given the complex nature of our overall global economy. Exactly what does simple mean to you?

Mr. HARRIS. Okay. I will go first.

I think it is predictable to go back to the earlier discussion, something that we can count on. Something that does not require a business to keep records and do things they would not do because it is necessary to run their business. When they are being required to do things only to comply with the tax law that they would not do to run their business, it has gotten too complicated. There are certain records we need to keep to run a business that we need to know to make sure our business is doing things properly, and to

the extent that what we do as a natural part of running our business allows us at the same time to comply with the tax law, that is simple. If we are doing things only to comply, it is no longer simple.

Ms. CLARKE. So let me just ask then. What you are asking then is that whatever you do to document the running of your business should be adequate enough to address the tax concerns of the United States' government?

Mr. HARRIS. In a perfect world, yes.

Ms. CLARKE. Okay.

Mr. HARRIS. There are obviously exceptions to everything but we should focus on the idea that what can we use that already exists or is in the best business interest of that taxpayer to keep for themselves before we add something just for a compliance purpose.

Ms. CLARKE. Okay.

Does anyone else want to answer simplicity? Or do you all—are you all in agreement with Mr. Harris's definition?

Mr. WATTERS. I agree.

Ms. CLARKE. You agree?

Mr. WATTERS. I agree as well. In fact, I think Mr. Griffith cited earlier that he has to keep four separate depreciation schedules for one piece of machinery and I think that is a great example of what Mr. Harris was saying, where just because the tax code is such—it is so complex and it forces you to do—to keep four separate depreciation schedules is crazy. And there are lots of examples throughout the tax code.

Ms. CLARKE. So to the extent that we can just distill that down so that that one depreciation schedule suffices for the purposes of the tax code, that simplifies things? Okay.

Let me ask one further question of you gentlemen.

Do you believe that the tax code is sort of like a living, breathing document? Is that sort of your experience?

Mr. HARRIS. I will go first again. Certainly from my perspective it is definitely living and breathing but it is about time for it to take its last breath.

Mr. GRIFFITH. It is certainly—if you have seen the tax code, it is a volume.

Ms. CLARKE. Yeah.

Mr. GRIFFITH. So there is a lot in there. So it definitely needs some simplification.

Ms. CLARKE. So to the extent that your companies I guess maintain a certain stability, they are not—they are doing, you know, relatively the same year in and year out but the tax code continues to add more—I guess more regulation or more requirement of documentation, it is not meeting the needs of your companies. Well, it is becoming more burdensome to the companies with each passing year than, for instance, it would be more burdensome this year than it was in the preceding year. Is that your experience?

Mr. GRIFFITH. Yes. If you take—for instance, just take Obama Care. When you have—they were going to allow small businesses to get premium reductions or credits back to help pay for the premiums and they benched it if you had more than 10 employees and less than 25 it was a phase out. And if you had an average of

$50,000, I mean, $250,000 average salary, phase that up to $50,000, you had a two-way computation. One was on number of employees and then the second one was on the average salaries. Taking those together, you had to add the two together and you have to do a very complex calculation to find out do I get any help? And there it is just a matter of what we are talking about is it is a lot of work and most companies in my industry did not get that because we are all over 10 and our average salaries are $125,000.

So there again, we are trying to comply and find out do we comply. We do a lot of work to find out, okay, we do not get that. So I think if we can get rid of a lot of that nonsense it would help.

Ms. CLARKE. Anyone else have any anectdotal—something that we can put on the record to sort of examine this or does that example suffice for all of you?

Very well then. Mr. Chairman, I thank you. Gentlemen, I thank you. I yield back.

Chairman GRAVES. Mr. Hanna. Make it quick.

Mr. HANNA. I will. Thank you.

I have a question. All of you are legitimate businesses. You pay your taxes. You are concerned or you would not be here. I want to ask about complexity and compliance in the underground economy. And Mr. Harris, in particular. What is your sense of that? I mean, mine is that it is growing daily for all the reasons that you are here, but there are a lot of people who do not have to fall within compliance. But I do not want to predetermine.

Mr. HARRIS. I think, and again, part of my background is spending time with the IRS Advisory Council. I got to see it from kind of both sides and I do not think there is any doubt that there is an underground economy. And I think that unfortunately sometimes the efforts to catch that gets in the way of doing common sense things for the honest person. But I think the more complexity you add, the more taxes you add that are unhidden, you are just encouraging more of it to be honest with you. The more records you have to keep, the more things you have to do, again, we know it is out there. I have got a sense it is growing, but because where it is it is hard to measure.

Mr. HANNA. Mr. Griffith, do you have a sense of that? People you know, businesses you watch? No names, you know.

Mr. GRIFFITH. I kind of lost my train of thought there. What was that question again?

Mr. HANNA. I am concerned that everything we do makes our laws harder to enforce and harder to comply with. Therefore, there is an incentive. I mean, Russia lowered their rates to I think it was 17 percent across the board. Compliance shot through the roof. It was easier to pay your taxes than go to jail or whatever. Do you have a sense in your own communities that that is growing? Or maybe you do not at all.

Mr. GRIFFITH. No. I am not certain.

Mr. WATTERS. Well, I am happy to say I do not know anyone who is participating in the underground economy, and we do not either, but it does seem that your logic is intuitive and makes sense. Yes. If there is one out there it is probably——

Mr. HANNA. I have just seen estimates that are 30, 40 percent of our overall economy. But that is okay.

I am good, Chairman. Thank you for the time.

Chairman GRAVES. Well, again. Thank you to all our witnesses for being here today.

Tax reform is such a critical issue to our nation's small businesses, and it is important that we continue to try to move the ball forward and provide some certainty to the small business community.

In addition to the testimony that we received here today we have had numerous trade associations that represent thousands of small businesses write letters to the committee expressing their ideas obviously on tax reform and simplification. We will be including those in the hearing record and also passing those on to the Ways and Means Committee as they move forward in this process.

And with that I would ask unanimous consent the members have five legislative days to submit statements and supporting materials for the record. Without objection that is so ordered. And with that the hearing is adjourned. Thank you all very much.

[Whereupon, at 2:52 p.m., the Committee was adjourned.]

APPENDIX

Testimony of Ways and Means Committee Chairman Dave Camp (R-MI)
House Small Business Committee
Small Business Tax Reform: Growth Through Simplicity
Wednesday, April 10, 2013
(Remarks as prepared)

Good afternoon Chairman Graves, Ranking Member Velazquez and Members of the House Small Business Committee. I'd like to take a moment to thank those small business owners who will appear on the next panel. I won't be able to stay for your testimony, but I thank you for taking time away from your businesses to be here today. You have first-hand knowledge of just how broken our tax code is; how much time, energy and money it takes to comply with; and what that means for you and your employees – fewer resources to grow your business, hire new workers, or help provide better benefits. You need and deserve a tax code that works for you. So, I appreciate you coming to share your ideas and adding your voice to the dialogue.

In preparation for today's hearing, I did a little bit of research. The last Ways and Means Committee Chairman to testify before the Small Business Committee was Chairman Ullman in September 1979. It was nearly that long ago that Congress reformed the tax code. Instead of making the tax code better, Congress has spent the last 27 years adding special provisions, making the code less effective and less efficient. That is something we must correct, especially for America's small businesses and their workers.

More Americans get their paycheck from small businesses than any other type of business or government. If we really want to strengthen our economy and put more money in the pockets of American workers, we must fix the tax code and how it treats small businesses.

Last month, I released a discussion draft aimed at creating a simpler and fairer tax code for small businesses. This discussion draft is part of a broader, comprehensive tax reform package that significantly lowers rates for individuals, small businesses and corporations. The goal of the draft is to spur greater job creation and higher wages by reducing the burden the tax code imposes on small businesses.

According to the National Federation of Independent Business, tax compliance costs are 65 percent higher for small businesses than for big businesses, costing small business owners $18 billion to $19 billion per year. In addition, nearly nine out of ten small businesses rely on outside tax preparers.

With about half of the private sector workforce employed by a small business – nearly 60 million Americans – these costs, along with Federal tax rates as high as 44.6 percent, are especially burdensome for a sector that has long been responsible for leading the nation out of economic downturns.

The discussion draft includes a number of core provisions that are designed to simplify tax compliance for small businesses, whether organized as sole proprietorships, partnerships, LLCs, or corporations. These proposals are not partisan. Democrats and Republicans have championed these ideas, and small business organizations across the country have supported them. The core provisions in the draft would:

- Spur investment in equipment needed to grow business operations by providing permanent expensing of investments and property under section 179 of the tax code;
- Simplify tax and accounting practices by expanding the use of the simpler "cash accounting" method to businesses with gross receipts of $10 million or less;
- Provide relief for start-up and organizational costs by establishing a unified deduction for these expenses; and
- Make tax compliance easier for partners and S corporation shareholders by reordering and simplifying the due dates of tax returns for partners and S corporations.

In addition, the discussion draft includes two separate options designed to achieve greater uniformity between the two main types of pass-through entities: S corporations and partnerships.

Option 1 is an incremental approach that improves the ability of S corporations to compete, grow and gain access to capital by modernizing current tax rules affecting S corporations and partnerships.

Option 2 is a more transformative approach that simplifies the tax treatment of non-publicly traded companies by repealing existing tax rules governing partnerships and S corporations and replacing those rules with a new unified pass-through regime.

Since we released the discussion draft, we have actively sought feedback from the small business community. The International Franchise Association, for instance, has said that "the proposal would reduce compliance costs and provide greater certainty to the more than 8 million employees across the country who wake up every day and go to work in the franchise industry and those Americans who aspire to become franchise business owners."

Mr. Chairman, I won't read all the comments we've received, but I do have a packet of feedback I am happy to share with the Committee Members and have included it in my formal testimony.

Simply put, the tax code ought to be easier to understand and less expensive for small businesses to comply with – because every dollar they aren't spending on taxes and tax compliance is a dollar they have to invest in equipment, start a new production line, hire a new employee or provide more in wages and benefits. That is my goal for comprehensive tax reform – a simpler, fairer tax code that leads to more jobs and higher wages.

Thank you.

Strengthening the Economy and Increasing Wages by Making the Tax Code Simpler and Fairer for America's Small Businesses

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Page 7: Small Business Draft: Unaddressed Issues and Questions

Overview

Whether operated as sole proprietorships, partnerships, or S corporations, small businesses continue to be the driving force for economic growth and job creation in the American economy and have generated 65 percent of net new jobs over the past 17 years according to the Small Business Administration.

Despite their significant contributions, however, small businesses and entrepreneurs face a daunting array of Federal tax rules and regulations that consume valuable time and resources. Consider the following small business facts:

- **Tax compliance costs are 65 percent higher** for small businesses than for big businesses, costing small business owners $18 billion to $19 billion per year.
- Nearly **nine out of every ten small businesses rely on outside tax preparers**, and according to data provided by the Internal Revenue Service, a business taxpayer spends an average of 23 hours on tax compliance.
- The current **patchwork of complex and often inconsistent rules** often leads to disparate results depending on the organizational structure of the business.

The combined impact of these tax costs and complexity means fewer resources to expand a business, hire new employees, and increase wages and benefits.

Tax reform done right should make the code simpler and fairer, while strengthening our economy. The discussion draft is the result of multiple public hearings and witness testimony. As part of a broader, comprehensive tax reform package that significantly lowers rates for individuals, small businesses, and corporations, **the draft reforms and simplifies a number of tax rules affecting small businesses and their workers**. The discussion draft **also offers two approaches to modernize the way the United States taxes pass-through businesses, such as partnerships and S corporations.**

In the interest of transparency, the Committee is soliciting feedback from a broad range of stakeholders, practitioners, economists, and members of the general public on how to improve this proposed set of reforms.

Small Business Draft:
Core Components

To help strengthen the economy by helping small businesses expand operations, hire new workers and increase wages and benefits, the discussion draft contains several commonsense reforms that simplify tax compliance for small businesses and provide certainty with respect to the ability of small businesses to recover certain costs immediately.

Spur Investment by Providing Permanent Expensing of Investments in Equipment and Property. The draft makes permanent section 179 expensing at pre-stimulus levels, allowing small businesses to deduct immediately investments in new equipment and property up to $250,000, with the deduction phased out for investments exceeding $800,000 (both amounts indexed for inflation). Without legislation, these levels will revert to $25,000 and $200,000, respectively, in 2014, which would be a tax increase for these employers. The draft also makes permanent the current-law provisions allowing computer software and certain investments in real property to qualify for section 179 expensing. This proposal is based on a provision of H.R. 886, introduced by Reps. Jim Gerlach (R-PA) and Ron Kind (D-WI). The proposal applies to tax years after December 31, 2013.

Simplify and Expand Use of Cash Accounting for Small Businesses. The draft replaces the current array of complicated tax-accounting rules that apply to small businesses and farms with a uniform rule under which all businesses with gross receipts of $10 million or less may use the cash method of accounting. The accounting rules for farming businesses would be coordinated with the new general rule, and sole proprietors would continue to be able to use the cash method regardless of the level of gross receipts. The discussion draft also coordinates the new cash-accounting rules with the uniform capitalization rules generally to exempt small businesses from the complex capitalization rules that require the allocation to their inventory of certain direct costs (e.g., materials and labor) associated with the production of the inventory as well as indirect costs (e.g., overhead and administrative expenses). This proposal is based on H.R. 947, introduced by Reps. Aaron Schock (R-IL) and Mike Thompson (D-CA). The proposal is effective for tax years after December 31, 2013.

Provide Relief by Establishing a Unified Deduction for Start-up and Organizational Expenses. For new businesses, the draft combines three existing provisions for start-up and organizational expenses into a single provision applicable to all businesses. Under a revised section 195, the draft increases the threshold for start-up expenses to $10,000 (up from $5,000), with a phase-out beginning at $60,000 of such expenses (up from $50,000) and expands the deduction to cover organizational expenses. The draft repeals the separate special rules relating to the organizational costs of corporations and partnerships. Expenses above the new limit continue to be deductible over the 15-year period following the start of the business. This proposal is based on a provision of H.R. 886, introduced by Reps. Jim Gerlach (R-PA) and Ron Kind (D-WI). The proposal is effective for expenses paid or incurred after December 31, 2013.

Ease Tax Compliance by Changing the Due Dates for Business Tax Returns. To assist taxpayers and tax professionals in filing tax returns accurately and on time, the discussion draft makes several changes to the current schedule for filing tax returns by the various types of small businesses. These changes address problems currently facing taxpayers and tax professionals

who often have insufficient time to prepare accurate returns, because required information from a business is not available under the current due-date schedule, which often requires them to seek extensions to accommodate these deadlines. Under the discussion draft:

- Partnerships must file by March 15 (or two and a half months after the close of their tax year).
- S corporations must file by March 31 (or three months after the close of their tax year).
- C corporations must file by April 15 (or three and a half months after the close of their tax year).
- Individuals, including sole proprietorships, continue to file by April 15.

All taxpayers are eligible for a six-month extension. This provision is based on H.R. 901, introduced by Rep. Lynn Jenkins (R-KS). The proposal generally is effective for tax returns filed for tax years beginning after December 31, 2013.

Small Business Draft: Two Options for Reforming the Rules for Small Businesses Organized as Partnerships and S Corporations

Despite their similarities, partnerships and S corporations are subject to two distinct sets of rules for Federal tax purposes. These rules result in significant tax-driven differences between different entity forms, including: capital structures, the allocation of income and deductions among owners, the treatment of contributions and distributions of property, and the treatment of debt incurred by the business. The draft provides two options for reform of the Federal tax rules applicable to pass-through businesses.

Option 1 – Revisions to Subchapter S and Subchapter K

To reduce the double taxation of business income, Option 1 incorporates a number of provisions from the S Corporation Modernization Act (H.R. 892, introduced by Reps. Dave Reichert (R-WA) and Ron Kind (D-WI)) intended to encourage C corporations to elect S status and provide greater flexibility to current S corporations in their day-to-day operations. With respect to partnerships, Option 1 establishes additional limits on the use of partnerships as tax avoidance structures without interfering with the legitimate business operations of partnerships, clarifies confusing areas of partnership law, and corrects a technical flaw with partnership rules to align them with S corporation rules. The specific revisions:

S Corporations

- Permanently reduce to five years (from ten years) the period following a conversion from C corporation status to S corporation status during which an S corporation must pay the highest corporate tax rate on certain built-in capital gains. In addition, the proposal makes permanent the rule that installment sales are governed by the provision applicable in the tax year when the sale was made.
- Increase to 60 percent (from 25 percent) the portion of an S corporation's income that may be passive without incurring an entity-level tax, and eliminate the current rule that terminates an S corporation's pass-through status if it has excess passive income for three consecutive years.
- Permit non-resident aliens to be S corporation shareholders through a U.S. electing small business trust ("ESBT" – a type of trust that is permitted to own stock of an S corporation), which better aligns the S corporation rules with the partnership rules. Accordingly, the trust must withhold tax on income earned from the S corporation, thus ensuring that non-resident aliens are subject to U.S. tax on their shares of S corporation income.
- Allow an ESBT to deduct charitable contributions made by the S corporation subject to the contribution limits and carryover rules applicable to individual donors.
- Modify the shareholder basis adjustment rules for S corporations making charitable contributions. This provision conforms the S corporation rules to partnership rules and provides a fair market value deduction for a charitable contribution, but limits the decrease in the shareholder's stock basis to the adjusted basis of the contributed property.
- Simplify the procedure and extend the time for making an S corporation election, permitting a corporation to make the election on its first tax return.

Partnerships

- Repeal the rules relating to guaranteed payments to partners, treating payments received by partners as either payments in their capacity as partners (i.e., part of their distributive shares of partnership income or loss) or in their capacity as non-partners. In addition, the draft repeals the special rule for deceased or retiring partners that treats certain payments in liquidation as guaranteed payments, subjecting such payments to the general rules.
- Require mandatory adjustment of a partnership's basis in partnership property when a partnership distributes property to a partner or a partner transfers his interest in a partnership, with corresponding adjustments in cases involving tiered partnerships. These provisions are designed to prevent abuses that result when: (1) property distributions shift the character of gains or losses among partners and (2) acquisitions result in the duplication of gains or losses.
- Adjust the limitation on a partner's share of losses to take into account charitable contributions and foreign taxes, conforming the partnership rules to the S corporation rules and thus preventing a partner from deducting losses in excess of basis.
- Clarify that all distributions of inventory items are treated as a sale or exchange between the partner and the partnership, eliminating the requirement that inventory be substantially appreciated in value to trigger gain recognition. This aligns the rule for distributions with acquisitions, assuring that the character of gain from ordinary items may not be converted to capital gain.
- Require that partners contributing property with built-in gains or losses be subject to tax on the pre-contribution gain or loss when the partnership distributes such property without the current limitation of seven years for recognition of such pre-contribution gains or losses.

Option 2 – New Simple, Unified Pass-through Rules

This option addresses long-standing concerns about the separate Federal tax rules applicable to partnership and S corporations and the different tax treatment that may result from the same transaction due solely to the business structure an entrepreneur selects at the state level (e.g., partnership, LLC, corporation). This option repeals current law Subchapter K and Subchapter S and provides a simple, uniform set of rules that apply to non-publicly traded businesses for Federal tax purposes regardless of how the business is organized at the state level. This unified regime provides a more efficient tax system for small businesses and pass-through entities. Specifically, the new rules:

- Encourage the formation of new businesses by allowing contributions of property and money on a tax-free basis.
- Avoid disruption of long-standing economic principles by maintaining the pass-through of items of income, gains, losses and credits, so that such items have the same character in the hands of the owners that they have in the hands of the entity.
- Reduce the use of complex structures to engage in tax avoidance by permitting only net ordinary income or loss, net capital gain or loss, and tax credits to be specifically allocated to owners.

- Close the tax gap while also simplifying the owner's current quarterly estimated tax responsibility by requiring entity-level withholding on the pass-through entity's income and gain with a corresponding credit for the owner's tax reporting.
- Prevent owners from gaming the tax system by using losses to reduce tax liability by limiting deductions for losses to an owner's basis in his pass-through interest, but allowing excess losses to be carried forward indefinitely.
- Ensure that taxes are paid on real, economic gains (but not on returns of capital) by limiting tax-free distributions to the owner's basis in the business.
- Prevent the use of pass-through entities to shift gains and losses amongst owners with different tax profiles by (1) requiring pass-through businesses to recognize gain on all distributions of appreciated property and (2) preserving losses in distributed property by requiring owners to take carryover basis in the distributed property.
- Conform to the basis rules that currently apply to partnerships by allowing owners basis in their ownership interests for entity-level debt (both recourse and non-recourse).
- Provide certainty with respect to owners who actively participate in the business by allowing owners to be treated as employees of the business.

Small Business Draft: Unaddressed Issues and Questions

Unaddressed Issues. The Committee recognizes that the discussion draft does not address certain technical and policy issues that may need to be resolved in final legislation. The Committee invites comments on how to address such issues, especially those related to:

- Employment and self-employment taxes of partners and shareholders, both under Option 1 (which preserves Subchapters K and S) and under Option 2 (which requires new rules for the employment and self-employment taxes of owners).
- The effect of the proposed threshold for cash accounting on other provisions of the tax code not directly related to accounting methods.
- Transition rules necessary to facilitate the adoption of new provisions by existing small businesses and pass-through entities, with a goal of minimizing disruption.
- The proper treatment of and potential problems faced by foreign partners in U.S. partnerships and U.S. partners in foreign partnerships in the context of a unified pass-through regime (Option 2). (Note that the draft does provide that current section 1446 overrides the proposed withholding requirement in the draft in cases where both apply.)
- Mergers, divisions, and reorganizations, with respect to Option 2.
- Conforming changes in Option 2 to integrate the new unified regime into the related tax rules.
- Other areas of small business taxation that are not addressed in the discussion draft.

Questions. While the Committee invites input on all aspects of the discussion draft, there are issues on which the Committee is especially interested in receiving constructive feedback concerning the options for reforming the tax rules governing pass-through businesses.

- Under current law, partners and S corporation shareholders are also subject to different requirements in other respects, including: treatment of different types of debt; allocations of income, loss, and deduction; and property distributions. How can these rules be coordinated and modernized to minimize the disparate treatment between partners and S corporation shareholders, in particular for owners under Option 2 in the discussion draft?
- Under Option 2 of the discussion draft, special allocations of tax items are not permitted to the same extent as current law. Instead, owners may allocate net ordinary income/loss, net capital gain/loss, and credits, with each owner allocated items equal to his or her proportionate share of each category. What effect do the allocation rules have on current partnership transactions where businesses (or assets) have been combined and each owner receives income from a separate business (or particular assets)?
- In light of the entity-level withholding proposed in Option 2, should the Internal Revenue Service be permitted to audit and assess tax liability at the entity level?
- How should tax-indifferent owners, such as pension funds and other tax-exempt organizations, be incorporated into the withholding proposal under Option 2?
- How can transition rules be designed to minimize the burdens on existing businesses currently treated as partnerships and S corporations with respect to adopting the modifications in Option 1 or Option 2?

Praise for Small Business Tax Reform Draft

Draft Will Create More Jobs & Higher Wages by Making the Tax Code Simpler & Fairer for Small Businesses

Wednesday, March 13, 2013

In a continued push to make the tax code simpler and fairer to strengthen the economy, Ways and Means Committee Chairman Dave Camp (R-MI) has released a tax reform discussion draft aimed at helping small businesses expand, hire new workers and increase pay and benefits. In response, groups representing the nation's small businesses praised the effort. More information about the discussion draft can be found here.

International Franchise Association:
"[T]he Camp draft would benefit the majority of America's 825,000 Main Street franchise small business owners by simplifying pass-through rules for S-Corps, LLCs and partnerships. By doing so, the Camp proposal would reduce compliance costs and provide greater certainty to the more than 8 million employees across the country who wake up every day and go to work in the franchise industry and those Americans who aspire to become franchise business owners."

Dean Zerbe, Columnist, *Forbes*:
"That tax reform for small and medium businesses organized as pass-thrus (S Corp; LLC; partnership, etc.) is even on the table for discussion is a victory. Many in Washington, D.C. have been pushing that tax reform should only be for the big boys – the C Corporations ('Corporate Tax Reform'). However, thanks to Chairman Camp (R-MI) – who has long championed that tax reform must be to the benefit of all businesses ('Business Tax Reform'), not just for those who can afford lobbyists – the benefits of tax reform will hopefully be shared with small and medium businesses."

S-Corp Association:
"The Committee draft…would improve the rules governing S corporations, making it easier for them to raise capital, manage their businesses, and transfer the business on from one generation to the next."

Small Business Legislative Council:
"Bold and innovative are words we associate with entrepreneurs. Ways and Means Committee Chairman Dave Camp (R-MI) is the entrepreneur of tax reform....It is important that we all analyze [his discussion draft] with an open mind and seize the opportunity to work with him to develop a tax code that will work to the benefit of the nation and its small businesses."

National Association of Manufacturers:
"We are pleased by Chairman Camp's efforts to move this debate forward by offering this latest discussion draft specifically focused on tax reforms for small businesses….If we stand still with our current overcomplicated, burdensome system, we will watch other nations surpass America in the global marketplace."

National Federation of Independent Business:
"Chairman Camp has shown an unwavering commitment to pursuing tax reform in a comprehensive manner. This is important, since more than three-quarters of small business pay taxes on business income at the individual rate. Chairman Camp's focus on making the tax code fairer and simpler for not just big businesses, but also small businesses, is commendable."

Americans for Tax Reform:
"Ways and Means Small Biz Draft a Great Step Toward Reform….[T]he Ways and Means Committee is moving toward a system with an individual rate no higher than 25 percent….When this budget target is combined with the common sense small business tax reforms contained in the draft released today, it's easy to see how the groundwork is being laid for more robust economic growth and job creation."

House Small Business Committee Chairman Sam Graves:
"The average tax compliance cost per employee for small businesses is almost three times the per employee cost for the average large firm. In order to address this inequity, Washington must begin a productive discussion on how to reform the system. I applaud Chairman Camp for doing exactly that in his discussion draft."

Employers and Experts Continue to Offer Positive Feedback on Small Business Discussion Draft
Tuesday, April 02, 2013

"'[M]ost companies will find value from the easier accounting' proposed by Camp. 'It would surely simplify the hodgepodge of tax codes that deal with partnerships and S Corps,' he says, adding that 'a unified system should make it easier for companies like mine to comply with the rules. I think Dave Camp is on to something.'"
(Termax CEO William Smith, CFO.com, March 20, 2013)

"This is an important step forward on the road toward comprehensive tax reform. The special attention Ways and Means focuses on small businesses is truly warranted. One of the major issues plaguing the economy today is the unfair burden taxes place on small businesses. The Ways and Means draft legislation would ease the burden of small businesses complying with our onerous tax code. It also paves the way for Ways and Means to address the larger inequities harming small business."
(Heritage Foundation, March 19, 2013)

"The Section 179 proposal is intended as part of an overhaul of the entire tax system. Other suggestions in the draft include doubling the deduction for start-up costs. Groups that lobby for small businesses say circulating the proposal publicly before it becomes a bill is a good move. 'This is the first time that I can recall when there's been a tax-reform discussion framed this way,' said Todd McCracken, CEO of the National Small Business Association."
(*Associated Press*, March 26, 2013)

"This draft moves the tax reform conversation forward, addressing many of the concerns the small business community faces and how the tax code can work better for America's entrepreneurs.... This discussion draft puts forth a legislative frame work that simplifies the tax code, lowers individual tax rates and modernizes the rules that govern pass-through entities. This will allow businesses to retain more of their earnings to invest in creating jobs and spurring economic growth."
(National Roofing Contractors Association, March 13, 2013)

"I give the chairman and his staff credit for trying to make some structural reforms beyond the headline-type issues.... This is the type of thing that is potentially a needed reform that doesn't capture the public's fancy but actually might improve the law."
(Professor George Yin - University of Virginia Law School, *Tax Notes*, March 18, 2013)

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Written Testimony

Of

R. Samuel Griffith, C.P.A.

President & CEO, National Jet Company, Inc.

And

Member, Board of Trustees, National Tooling and Machining Association

Before the

U.S. House of Representatives Committee on Small Business

Wednesday, April 10, 2013

Thank you for the opportunity to testify before you today about the impact of tax reform on small and medium sized manufacturing businesses. My name is Sam Griffith; I have been President and CEO of National Jet Company in LaVale, Maryland for the last 20 years having purchased the company in 1992. I am also a member of the Board of Trustees and Chairman of the Audit Committee of the National Tooling and Machining Association (NTMA) and I am testifying here today on behalf of my company and also representing the NTMA members and industry.

As further background, not only am I a manufacturer, I am also a Certified Public Accountant (CPA), and I remain involved with the Maryland Association of CPA's and American Institute of CPA's. I began my career practicing as a certified public accountant with the international firm of Coopers & Lybrand known today as Price Waterhouse Coopers. I practiced for 13 years and I was an Audit Manager when I left the firm to join York Oil Company as Chief Financial Officer.

National Jet Company was founded in 1937, and today is an internationally known expert in precision micro drilling technology. We have the capability to drill holes as small as two ten-thousandths of an inch in diameter. We can drill or EDM (electrically discharge machine) holes in any shape and we hold very close tolerances for our work. To give you an idea of size, we can drill a hole in a human hair. We service primarily the aerospace, automotive, electrical, medical, and textile industries. Some of the products we are involved with include extrusions dies for the production of man-made fiber for the carpet industry, AstroTurf for the athletic fields, injector plates for autos, spray nozzles and orifices. We are a small specialty shop with twenty-four employees and have added two new employees in the last four months.

National Jet is structured as a subchapter S Corporation, which means all income flows into my personal return and I then pay taxes at the individual rate which puts me into a much higher tax

rate than I normally would be due to the pass through of the corporate income into my personal return.

As I mentioned earlier, prior to purchasing the company, I served as the Chief Operating Officer and the CFO of the York Oil Company in Hampton, Virginia, a subchapter C Corporation. Given my combined training as a CPA, and having worked in both a C and an S Corporation provides me with a unique perspective on tax policy.

The National Tooling and Machining Association represents roughly 1,500 manufacturing businesses who average 35–50 employees and are typically classified under the North American Industrial Classification System (NAICS) as 332 (Fabricated Metal Product Manufacturing) and 333 (Machinery Manufacturing). These classifications include 80,000 manufacturing establishments nation-wide according to the U.S. Census. We are normally referred to as contract machine shops.

The National Tooling and Machining Association and I wholeheartedly support tax reform that includes real reform for both C Corporations and pass-through companies which make up the majority of small businesses in this country. We desperately need lower rates, simplification of rules and elimination of the sunset provisions in the tax code to allow us to compete globally. It is very difficult to plan into the future when there is such uncertainty in the tax code. No one likes a moving target and for the last ten years it has been a nightmare to plan.

A recent survey of NTMA members showed that sixty-seven percent are structured as a pass-through business. Eighty-one percent of all manufacturing businesses are structured as pass-throughs, further reinforcing the importance of including these types of companies in tax reform.

Why Most Manufacturers are Pass-throughs

The reason most small manufacturers structure themselves as pass-through, in part, because many are family-owned businesses who want to keep the company in the family when the current owners retire. This is particularly true with most NTMA members who are now planning the transition from the third to the fourth generation of manufacturers.

The other reason is more obvious; the double taxation of C-Corporations' dividends which the owners pay when they take their earnings out of the business. No one wants to pay double taxes on their hard earned income. After all, when the owner pays a higher tax rate, it really means the company is paying more in taxes and has less to buy equipment and hire employees. Furthermore, what many people do not know is a small business owner has to personally guarantee loans for the company when buying equipment which can cost in the millions—the fewer resources we have available to show our lenders, the more difficult it is to obtain financing to expand.

To better understand the impact of various tax reform proposals on small and medium sized manufacturers, the Association worked with Michigan-based accounting firm Plante & Moran to develop a

tax template to model different scenarios. Attached to these comments is Exhibit "A" for the record which is an example of a New England-based small manufacturing business structured as an S Corporation with five shareholders and two hundred employees. While larger than the average NTMA business, this company's tax template shown here demonstrates what happens to a manufacturer when Congress fails to stabilize tax policy.

A pre-fiscal cliff calculation showed this New England manufacturer paying a combined federal, state, and local effective tax rate of 31.5% in 2011. An examination of the Fiscal Cliff scenario which went into effect for a few hours on January 1, 2013 resulted in a 46.91% effective tax rate for this company with virtually all deductions and credits eliminated or reduced and a 39.6% statutory individual income tax rate. This scenario showed the company would owe an additional $715,000 in federal taxes on $4.6 million in adjusted taxable income. This 15% increase in their effective tax rate means they have fewer resources to purchase new equipment and hire more employees in New England as would we in Maryland.

Tax Credits and Deductions Manufacturers Use

Every manufacturing business is different and each company serves a variety of industries which has varying needs and requires specialty equipment. Based on a December 2012 survey of the National Tooling and Machining Association and Precision Metalforming Association, the 200 respondents identified using the following tax credits and deductions:

- Section 179 Equipment Expensing
- Bonus "Accelerated" Depreciation
- Research & Development Tax Credit (R&D)
- Section 199 Domestic Production Activities Deduction
- Last-In-First-Out (LIFO) inventory valuation
- Interest Charge Domestic International Sales Corporation (IC–DISC)
- Net Operating Loss (NOL)

We recognize that policymakers face many difficult decisions ahead in reforming the tax code. You will have to decide which deductions and credits you will eliminate or keep in place. However, to remain globally competitive, small businesses use several credits and deductions to free up resources to reinvest back in our business. While each year is different, in 2010, National Jet Company reinvested 137% of our net income into the company and in 2011 we reinvested 112% back into the company.

While most of our industry is made up of small businesses with fewer than fifty employees, our capital equipment needs are significant and many machines are very expensive and start at a few hundred thousand dollars and range into the millions. To further emphasize the importance of capital equipment to these businesses, eighty-nine percent of survey respondents claimed Section 179 Equipment Expensing in 2012 while eighty-eight percent used Bonus "Accelerated" Depreciation. This means that our members maxed out their Section 179 deduction and then still turned to accelerated depreciation to support their investments in the company.

Remember, when you buy a machine, you usually need to hire someone to run it. Expansion equal jobs.

At National Jet, in 2011, we claimed $400,000 in Section 179 Equipment Deduction. However, in 2012, the Section 179 limit was $139,000 with a phase out if you purchased over $560,000 in equipment. Our company needed a machine that cost $611,000 but if we purchased this equipment we would lose the Sect. 179 deduction because it exceeded the phase out provision. This one piece of equipment exceeded the entire limit. Therefore, I only purchased $130,000 worth of smaller equipment to stay within the threshold of the tax provision.

Then Congress on December 30, 2012 passed a provision allowing a Sect. 179 deduction of $500,000 and increased the phase out provision to $2,000,000. Now how could any small business react to this? One day in which to purchase a machine that weighs 36,000 pounds, transport it, have electrical lines installed, run air lines to the machine and have it placed in service all in 24 hours? No one could do this. However, Congress pats themselves on the back for passing legislation to help small business and moves on to the next issue. Small business did not get the benefit because of the last minute action by an otherwise action less Congress. Thanks for nothing. This is exactly why I am here today.

If it were not for the uncertainty surrounding the status of the Section 179 Expensing provision on Capitol Hill last year, I would have invested another $400,000 in equipment and hired two additional employees to run the machines. With all due respect, the failure of Congress to do its job should not prevent me from creating jobs.

The Section 199 Domestic Production Activities Deduction is one of the few provisions in the tax code which directly incentivizes manufacturing in America. Roughly half of our members claim Section 199 which amounts to an effective three percent rate reduction for most domestic manufactures. We claimed $31,000 in 2012 nearly double in 2011 because of a rebound in business after the Great Recession that still lingers among some small businesses today, especially those who are still suffering under a Net Operating Loss.

Another issue which receives many headlines when tax reform is discussed is the Alternative Minimum Tax, or AMT. Most members of Congress probably only think about the AMT in terms of its impact on the average “middle class” family. But its reach is far broader.

Because our business is captured under the AMT, we cannot claim the Research and Development Tax credit which would be available to us and is to popular among politicians. In addition, when I hired a long-term unemployed person in my shop last year, I thought I could claim the $1,000 credit Congress passed into law to encourage this kind of action. Again, because I am under the AMT, I also cannot claim that credit. So you give us credits for R&D and employing workers who have lost their unemployment benefits and then you take them away because of the AMT. How does this make any sense?

As Washington explores comprehensive tax reform, you will decide which tax credits and deductions you will eliminate along the way—whether to reduce the rates, raise revenues, or both. I ask that you keep in mind which of these provisions help stimulate growth in the economy and truly create jobs. For example, if it were not for the $400,000 in Section 179 we claimed in 2011, my effective tax rate would have been significantly higher and I would likely not have had the capital to purchase the equipment we needed to grow the company and hire employees.

Conclusion

As you can see, the current tax code is a maze of mismatched provisions which provide disincentives to grow our businesses and hire new employees. Good intentions by lawmakers often result in temporary tax provisions which do not allow a small business to plan, to secure loans, and to hire employees. While we are just starting 2013, I am already budgeting for growth and purchasing equipment in 2014—and hopefully hiring more employees.

We can't just purchase a machine on December 31st by midnight based on a vote Congress just took. It takes time to place this equipment into service even if we had the free capital to make a last minute multi-million dollar purchase based on Congressional action, or inaction.

We fully support Chairman Dave Camp's approach and efforts by others to push for comprehensive tax reform and applaud this committee for holding this hearing to focus on the impact on small businesses. Our greatest concern is a seeming obsession with corporate-only tax reform—a path which leaves America's small businesses and eighty-one percent of U.S. manufactures behind.

Thank you for the opportunity to testify before you today on this important issue. I believe we must develop a reformed tax code which encourages manufacturing in America and helps our small businesses compete globally in the 21st Century. We have a stake in this great country and we want our voice heard.

STATEMENT FOR THE RECORD

MR. STEVEN BEARDEN

LINEMARK

and

PRINTING INDUSTRIES OF AMERICA

BEFORE THE

HOUSE COMMITTEE ON SMALL BUSINESS

"Small Business Tax Reform: Growth Through Simplicity"

Chairman Graves, Ranking Member Velazquez, and members of the Committee, good afternoon and thank you for inviting me to testify today.

I am Steve Bearden, President of Linemark, a privately-owned printing and graphics communications company headquartered in Upper Marlboro, Maryland. Linemark is a 27-year old company that employs 92 workers. I am also here as a member of Printing & Graphics Association of the Mid-Atlantic and of Printing Industries of America.

Despite tough economic times that saw the industry lose over 75,000 jobs in the past four years, printing companies like Linemark are ready to come back. It's critical that tax policies are in place that will allow us to do so.

Chairman Camp's overall goal of simplifying tax rules concerning small business in order to reduce the impact of tax costs and complexity is one both Printing Industries of America and I, personally, can and do support.

My comments this afternoon will focus on three specific provisions of the discussion draft.

The first is: *Making permanent section 179 expensing to allow Linemark and other small businesses to deduct investments in new equipment and property up to $250,000.*

This provision is vital to the future growth and job creation of my company and others like mine. In the environment of a rapidly changing communications marketplace, it is vital that small printers be able to continually modernize their product and service offerings. When I say I'm in the printing business, I'm often asked if the Internet is killing off my profits. People are surprised to hear it's quite the opposite; there are tremendous growth opportunities in combining old school ink-on-paper printing with online and social medial technologies. But it takes serious capital investment in order for small printers to evolve.

For example, in 2012 Linemark had purchases over $2,500,000. This included a $2,200,000 printing press, a $174,000 Esko

Kongsberg router system, an $82,000 Komfi laminator and a new $17,000 VOIP phone system. By utilizing bonus depreciation, we did have an incentive and the additional resources to make investments in our company's future growth. In the future we will be upgrading to digital printing presses, which is the predicted growth area in the printing industry, and will be adding a new large format printer and expanding our bindery functions—both of which will allow Linemark to better compete in ancillary services that are critical to staying alive in the new print marketplace.

Small printers across the country would benefit similarly in their ability to grow if section 179 expensing was made permanent. The typical printer plans on spending around $50,000 to $100,000 on capital equipment this year. Generally, higher profit printers are more likely to invest in capital equipment and to invest higher amounts than lower profit printers. These profit leading printers are the most likely to create new jobs. The impact is also positive for small suppliers that manufacture printing equipment, many of which are also members of Printing & Graphics Association of the Mid-Atlantic and of Printing Industries of America.

The second is: *the provision that would simplify and expand use of cash accounting for small business.* The typical printing plant is small with around $3.3 million in annual sales and 20 employees. Many of these small firms would find new cash accounting rules helpful as Linemark would have when it was smaller. However, I should note that with this proposal, C corporations with gross receipts up to $10 million would gain the option of using cash accounting, but larger S corporations would lose it. More than 800 printing plants are S corporations and would fall into this category.

Finally, the discussion draft poses *two options to reform the rules for small businesses organized as partnerships and S corporations.* Approximately 20 percent of the industry is comprised of sole proprietorships or partnerships. Another five in ten printing firms are organized as S corporations. Linemark is a C corporation, but we do recognize that many other printing companies use the S corporation to simplify their structures.

I would also like to briefly mention the estate tax. The new exemption levels passed by Congress early this year are very helpful to companies like Linemark as I prepare for my two children currently working with me to hopefully stay with the family business in the future.

In conclusion, I urge this Committee and all Members of Congress to continue this important dialogue and to maintain a strong focus on how comprehensive tax reform legislation will impact America's small printers and small businesses in all industries.

Thank you, and I look forward to answering any questions you may have.

Industry Numbers

- The average printing company employs 27 workers; 60% are family-owned businesses. At the end of 2012, there were approximately 47,000 printing and related establishments in the US employing around 970,000 workers.

- Despite tough economic times that saw the industry lose over 75,000 jobs in the past four years, Printing Industries of America predicts on average 3.0% to 4.0% growth in 2013. But overall printing industry sales are forecasted to decline by about 1.0% due to the number of firms going out of business over the year.

- The typical printer plans on spending around $50,000 to $100,000 on capital equipment this year. Smaller printers plan to spend less—typically $50,000 and one-in four plans to spend less than $10,000.

- Although the printing industry is very large in a macro sense with over $156 billion in annual shipments, some 47,000 plants and almost 970,000 employees it remains America's largest *small* manufacturing business with two-thirds of all establishments or more than 30,000 employing fewer than 10 employees. Additionally, another 14 percent of printers employ 10–19 employees. On average, the typical plant is small with around $3.3 million in annual sales and 20 employees.

- As an industry, printing is composed of very few public companies. While 32% are setup as C corporations, only a handful are publicly traded.

- In any given year there are perhaps a few hundred start-ups in the printing industry. As expected the vast majority of these start-ups are small firms—most with less than 20 employees and less than $3 million in annual sales even years after their business was started.

AED Government Affairs Office
121 North Henry Street
Alexandria, VA 22314
Telephone: 703.739.9513
Facsimile: 703.739.9488
E-Mail: aeddc@aednet.org

SMALL BUSINESS TAX REFORM: GROWTH THROUGH SIMPLICITY

STATEMENT OF TIMOTHY WATTERS, PRESIDENT & CEO, HOFFMAN EQUIPMENT CO., PISCATAWAY, NEW JERSEY

ON BEHALF OF ASSOCIATED EQUIPMENT DISTRIBUTORS BEFORE THE U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON SMALL BUSINESS

Chairman Graves, Ranking Member Velázquez, and other distinguished members of the committee, my name is Tim Watters, and it is my pleasure to appear before you today both as a small business owner directly impacted by tax reform, and in my capacity as vice chairman of Associated Equipment Distributors' (AED) Board of Directors.

I am the president and CEO of Hoffman Equipment Co., an 87-year old family-owned business headquartered in Piscataway, New Jersey. Hoffman sells, rents, and services Case, Liebherr, Terex, JCB, Grove, Manitowoc, and other leading brands of construction equipment from five locations in New Jersey and New York. We have 65 employees and our distribution territory includes New York's 12th congressional district.

AED is the trade association representing distributors of construction, mining, energy, forestry, industrial, and agricultural equipment. AED has more than 500 members, ranging in size from small dealerships with one location and a handful of employees to larger companies with thousands of employees and dozens of locations across several states. However, the overwhelming majority of AED's members are small, family businesses; AED's average member achieves about $40 million per year in revenues and employs 80 people.

I appreciate the opportunity to come before the committee to discuss how the small business-dominated equipment industry fits into the tax code and suggest ways to improve it to spur economic growth and job creation.

Tax Reform & the Construction Equipment Industry

AED recently conducted the most comprehensive tax survey the association has completed in years. The results provided a highly reliable industry sample and a compelling snap shot of the tax code's impact on our industry.

To put in perspective, it's important to understand where the construction equipment distribution sector fits into the overall economy. Survey respondents reported collective annual revenues of approximately $11.3 billion in 2011 and more than 20,000 employees. Average sales per employee were $562,108. Projected across AED's entire membership, the association estimates its U.S. dealer members earned $26.67 billion in total revenues in 2011 and employ close to 47,000 people.

Based on an earlier economic study conducted by Stephen Fuller, Ph.D., the Dwight Shar faculty chair at George Mason University (GMU) in Fairfax, Virginia and director of GMU's Center for Regional Analysis, which found that each dollar spent at an equipment distributorship creates $3.19

in direct, indirect, and induced economic activity, AED estimates its membership's total economic impact at $85 billion.[1]

The equipment industry is dominated by closely-held, pass-through entities. Consequently, it is vital that tax reform not just focus on C-corporations and publicly-traded companies. It must also benefit the pass through entities and smaller businesses that are the lifeblood of the economy. In total, two-thirds of survey respondents classified themselves as either S-corporations, Limited Liability Companies (LLCs), or Limited Liability Partnerships (LLPs), while 34 percent of AED dealer member companies are C-corporations. The respondents classifying themselves as either C or S-corporations had 5.5 shareholders on average; partnerships had an average of 2.4 owners.

Additionally, equipment distributors do more than just sell equipment. New and used equipment sales account for just less than half of the average survey respondent's revenues, while parts, service, and product support account for almost one-third of revenues. Dealers help make their customers more efficient by providing a wide range of equipment acquisition options. Congress should understand that AED members do more than just sell equipment. Tax laws and IRS rules must provide sufficient flexibility to allow our members to serve a diverse array of equipment markets and types of customers.

It should also be noted that AED's membership believes tax uncertainty is dragging the economy down and equipment distributors are open to comprehensive solutions. In AED's 2012 Government Affairs Survey conducted last spring, ninety-six percent of survey respondents agree or strongly agree that "the uncertainty surrounding the tax code is undermining the nation's economic vitality." Seventy-two percent of respondents agree or strongly agree that "balancing the federal budget will require a combination of spending cuts, entitlement reform, and across-the-board tax increases," and that "everyone should shoulder some of the burden." Fewer than one-third (only 32 percent) agree or strongly agree that "tax increases should be off the table as a way to address the budget deficit." But 63 percent disagree or strongly disagree that "high earners should be taxed at higher rates to prevent tax increases on low- and middle-income families.

Given the aforementioned, it is clear that my company and the broader industry have a significant stake in any changes to the tax code and are eager to participate in the process.

Change Passive Income Rules

One of AED's top priorities in comprehensive tax reform is changing the Internal Revenue Service's (IRS) rules to ensure the Affordable Care Act's new 3.8 percent tax on passive income doesn't impact construction equipment distributors renting equipment.[2]

While contractors and other users traditionally purchased the equipment they used on construction projects, over the last 25 years there has been a significant shift towards rental. This trend has accelerated in recent years as a weak economy and uncertainty surrounding government

[1] Stephen Fuller, PhD., *Sales of Heavy Construction Equipment as a Percentage of Construction Spending and Related Economic Impacts* (2008) <http://www.aednet.org/government/pdf-2008/Fuller-Report.pdf>
[2] Pub. Law 111-148.

infrastructure programs have made contractors more hesitant to buy new equipment. Equipment rental transactions take the form of a "rental with the option to buy" or a pure rental.

According to AED's recent tax survey, equipment distributors earned $1.29 billion in total rental revenues in 2011, an average of $12.03 million per company. AED projects its members' 2011 rental revenues were more than $3.3 billion.

While passive loss rules adopted in the 1980s were designed to prevent wealthy individuals from using losses from passive activities to avoid paying income taxes, due to anomalies in the Internal Revenue Code and IRS rules, the income and losses that equipment companies derive from renting bulldozers and other machines to contractors are considered "passive".[3] The passive loss issue has long caused headaches for equipment companies, but the issue has taken on new urgency since the enactment of the Affordable Care Act, which imposes a new 3.8 percent tax on passive income, effective this year. In 2013, equipment dealers will become subject to a tax they were never meant to pay.

The tax was designed as an "unearned income Medicare contribution tax". In the case of an individual (most equipment distribution companies are pass through entities, so the companies' taxes are those of the individual owners), the tax is 3.8 percent of the lesser of net investment income or the excess of modified adjusted gross income over the threshold amount ($250,000 in the case of joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case).

In creating the new tax, Congress sought to limit its applicability and only ensnare a select group of individuals (financial traders and those deriving income from passive activities). Congress did not intend the law to apply to companies like equipment distributors. However, due to the complexity of the tax code and related regulations, companies that rent equipment have fallen into a trap and will be forced to pay a tax that was not meant for them. We are therefore asking Congress to do what it has done for other similarly-situated industries[4] and clarify that income from equipment rental is not passive income.

Preserve the Business Interest Deduction & Sec. 179 Expensing

Credit drives the equipment industry and is critical both to my customers' ability to buy equipment and AED members' ability to keep the doors open for business and finance rental fleets. Consequently, AED considers the business interest deduction to be critical to long-term growth.

According to AED's tax survey, the combined interest expense deduction for 2011 reported by survey respondents was $92 million, an average of $872,000 per company. By contrast, the total interest expense deduction reported by respondents for 2007 was $163.19 million, an average of $1.75 million per company. The total projected interest deduction for all AED members in 2011 was

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[3] Internal Revenue Code (IRC) Sec. 469(c)(2) provides that except as provided in paragraph (7) the term "passive activity" includes any rental activity.

[4] IRC Sec.469(c)(7) provides that paragraph (2) shall not apply to any rental real estate activity.....where the taxpayer is considered a real estate professional.

$232.05 million, while the total interest expense deduction in 2007 was $468.53 million. Congress must protect this important deduction when revamping the tax code.

Additionally, as proposed by Chairman Camp in his small business discussion draft, Congress should extend and expand Sec. 179 expensing levels. This capital investment incentive encourages growth, expansion, and purchases, which benefit the entire economy.

Find New Revenue Streams to Support Federal Infrastructure Investment

Transportation infrastructure is critical to America's economic growth and competitiveness. The surface transportation reform law enacted last summer (MAP-21) provides some near-term certainty. However, when it comes to highway, bridge, and transit investment, the job is far from complete. Gas taxes and other highway user fee revenues are insufficient to support even the current inadequate level of transportation investment, let alone the additional construction needed to rebuild America's crumbling infrastructure. Without new revenues, the highway program is in true jeopardy.

In fact, according to College of William & Mary researchers, over the next 23 years, as Corporate Average Fuel Economy (CAFE) standards rise, gasoline consumption will decline.[5] This will lead to a drop in gas tax payments to the federal Highway Trust Fund (HTF), the highway program's primary funding source. Failing to change the existing tax structure while maintaining current investment will cause the HTF's account to incur a $365.5 billion deficit over the next 23 years, the study concludes.

The highway program is already in dire straits. Although it has been self-sustaining for many years thanks to the gas tax and other user fees, declining revenues have made transfers from the general budget necessary to prevent road and bridge spending cuts. Many studies have shown that merely maintaining current spending is insufficient to build the infrastructure our growing economy needs. One report by the Texas Transportation Institute found that traffic congestion, largely resulting from inadequate capacity, costs the country more than $100 billion per year in wasted time and fuel.

The William & Mary study offers a few possible solutions. The gas tax was last increased - to 18.4 cents per gallon - in 1993. The research team determined that restoring the gas tax's 1993 spending power by raising it to 25 cents and indexing it for future inflation would raise $167 billion above current baseline spending requirements over the next two decades. The study also examined ways to implement a vehicle mileage-based user fee.

We must create new Highway Trust Fund revenue streams through a gas tax increase, a vehicle miles traveled tax, or some other innovative solution. These could and should happen (as they have in the past) as part of a broader budget and tax reform deal. AED and its members are committed to working with you to build public and political support for these policies.

Oppose LIFO Repeal

LIFO (which stands for "last in, first out") is an inventory accounting method that has been used by companies in a range of inventory-intensive industries since the 1930's to manage inflation's impact.

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[5] *The Impact of Fuel Use Trends on the Highway Trust Fund's Present and Future* (2012) http://www.aednet.org/government/pdf-2013/WM-HTF-Report.pdf

LIFO takes into account the greater costs of replacing inventory, providing a more accurate measure of the financial condition of the business and the income to which tax should apply.

LIFO is an accounting method, not a tax loophole. When inventory costs are rising, using the LIFO method will mean less tax liability in a given year than under the FIFO ("first in, first out") method. However, if prices fall, the taxpayer would repay the LIFO benefit through greater tax liability. Moreover, taxpayers may not change between LIFO and FIFO without Internal Revenue Service (IRS) approval, thus once a company elects to use the LIFO method, it assumes the risk of artificially increased tax liability if inventory costs should fall.

Proposed in President Obama's budget proposals, repealing LIFO would have a devastating impact on both large and small companies alike - particularly members of the equipment industry. Thirty percent of AED members reported using the LIFO inventory accounting method and 28 percent use first in, first out (FIFO). The average reported LIFO reserve was $8.16 million. Survey respondents reported combined LIFO reserves of $220 million. AED projects that its members have approximately $588 million in combined LIFO reserves and repeal would mean close to $200 million in retroactive tax liability.

While Hoffman Equipment Co. doesn't use LIFO, many of my industry colleagues have expressed a great deal of concern about the impact repeal would have on their ability to grow and even remain in business.

Repeal the Estate Tax
As AED has documented in study after study, the federal estate tax takes an enormous toll on the capital-intensive, family business-dominated construction equipment industry. Earlier this year, the Taxpayer Relief Act permanently fixed the top estate tax rate at 40 percent and the personal exemption rate at $5 million, indexed for inflation. Restoring predictability to the estate tax was a good start, but Congress needs to do more.

Forty-four percent of AED tax survey respondents said that their company had purchased life insurance for the current owners to protect the company from the federal estate tax. The total expended by survey respondents on estate tax-related life insurance was $11.3 million, an average of $221,100 per company. Similarly, 45 percent reported having hired attorneys and accountants to create estate plans to protect their business from the federal estate tax. The total spent by respondents on estate planning lawyers and accountants over the past three years was $2.83 million, an average of $54,000 per company. AED projects that its members spend a combined $31.82 million on estate tax-related insurance premiums annually and that over the past three years equipment distributors have spent a combined $6.69 million on estate planning lawyers and accountants.

AED maintains that the tax is fundamentally unfair because it disproportionately penalizes family businesses and amounts to double taxation. It should be repealed in its entirety. However, in the alternative, Congress must come up with a simple way to mitigate the negative impact on family

companies, for example, by only taxing assets at sale, allowing them to pass from generation to generation without being taxed.

Conclusions

AED members overwhelmingly believe that the uncertainty surrounding the tax code is dragging down the economy. Equipment distributors understand the situation is complicated and are open to a comprehensive solution to our tax and fiscal problems. The majority of our members agree that balancing the federal budget will require a combination of spending cuts, entitlement reform, and tax increases. However, tax reform should be fair, support business risk-taking and investment, and everyone should share in the burdens and benefits.

For the results of the reform debate to be credible and widely acceptable, the process must be bipartisan and stakeholders from all sides must be part of the dialogue. We also believe that restoring balance to our nation's fiscal structure is a prerequisite to resuming robust economic growth, rising employment, and improving standards of living for all Americans.

Statement of Roger Harris

Before the U.S. House of Representatives Committee on Small

Business

President and Chief Operating Officer

Padgett Business Services

April 10, 2013

Good afternoon, I am Roger Harris, President and Chief Operating Office of Padgett Business Services.

For nearly fifty years Padgett Business Services has been providing accounting, income tax planning and preparation, payroll and payroll tax services to thousands of small business owners through our network of 300 offices across the United States. Our clients generally have 20 or fewer employees and are what some people would consider "mom & pop" businesses. Based on recent studies almost 90% of all firms that have employees operate in our target market. In addition to my forty plus years with Padgett I also had the honor of serving on the Internal Revenue Advisory Council for four years and was its Chair for two of those years. I believe this experience gives me a balanced approach to small business taxation—I have had the opportunity to see what works and what doesn't work in the real world.

A wise man once said tat owning your own business is about doing the one thing you love and 99 other things you MUST do but dislike. I can tell you with some certainty that for most small business owners at the top of that list is taxes and tax compliance. It is my experience that, while no one likes paying taxes, most hate the paperwork and time devoted to complying with the tax laws on an almost equal basis.

Over the years it has become clear to me that for most entrepreneurs the business checking account is the focal point for their bookkeeping. It is how they measure cash flow and profits, and to a great extent is the basis for their tax accounting as well. First working with President Bush's Advisory Panel on Federal Tax Reform and most recently with David Kautter, Professor of Taxation and Executive Director of the Kogod Tax Center at American University, we have developed a legislative tax reform proposal—the Simplified Cash Method—that we believe would provide significant simplification, improve cash flow, encourage entrepreneurship and improve compliance for the Nation's millions of small businesses.

In a nutshell, the proposal is as follows:

- **Qualifying taxpayers electing to use the Simplified Cash Method would be required to have a dedicated small business checking account (or accounts) associated with a single EIN.**

- **In order to take advantage of the Simplified Cash Method, all cash receipts and disbursements must pass through the dedicated account.**
- **Taxable income is based solely on amounts actually received**
- **Deductions would be allowed when made for cash disbursements for inventory, prepayments, capital assets and depreciable assets.**
- **Payments made for leasehold improvements would be deducted as cash disbursements are made. All other real property rules would be governed under current law.**
- **Banks would report annual gross cash receipts and disbursements to the IRS and IRS forms shall provide means on the tax return to reconcile any cash flows not income or a deductible disbursement.**

The Simplified Cash Method would have the advantage of making the business checking account the "books" for the small business. A tax practitioner would rely almost solely on it for preparing the tax return. The Internal Revenue would have the same information to decide on which businesses to audit or contact. The tax return would provide the flexibility for the taxpayer to explain differences between what is reported to the IRS and what is on the tax return. By comparison, today's rules require many small businesses to separately track and compute depreciation, amortization, inventory capital expenditures and other items, strictly for tax purposes. On the flip side, the IRS receives only parts of the information necessary for selecting taxpayers for compliance actions. We believe that both sides win from this proposal.

We were pleased to find many of the same principles of our plan in Chairman Camp's Ways and Means white paper. I believe it takes a big step toward a more simplified tax world for small business, especially the following provisions:

- **Permanent section 179 expensing, including leasehold improvements and computer software.**
- **Increasing the threshold for Cash Basis small business exception to $10 million and simplifying its application.**
- **Coordinating the new cash-accounting rules with the uniform capitalization rules generally to exempt small businesses from the capitalization rules that require the allocation to their inventory of certain direct costs (e.g., materials and labor) associated with the production of the inventory as well as indirect costs (e.g., overhead and administrative expenses).**
- **Combining three existing provisions for start-up and organizational expenses into a single provision applicable to all businesses and increasing the threshold to $10,000.**

It is my sincere hope that the Committee on Ways and Means will consider further simplifying the inventory rules to that most business with inventory and under the $10 million gross receipts would benefit from additional simplification.

The white paper also provides an interesting discussion on reforming the rules governing tax structures, partnerships and S corporations. As a general rule, it is important to keep in mind that small businesses do not plan always their tax structure they simply evolve to the situation. I would like to illustrate that with a story I have told to many audiences.

When a person mows his own lawn, it's considered a hobby. If the neighbor notices he does a good job and offers to pay him to mow his lawn, he becomes a sole proprietor. When he signs up enough neighbors, he brings in a friend and they become a partnership. At that point, the two of them realize that all the tax accounting and legal issues are too complicated and they seek out help and are advised to become an LLC. Without any planning their life got much more complicated but to them they are still just cutting grass. What we should all want for these people is for their business to continue to grow so they continue to hire more people to keep up with demand. The only way for that to happen is for them to keep cutting lawns instead of keeping unnecessary records.

With this in mind, I would like to comment on the following issues in regard to option 1 of the white paper:

The proposed changes in this section are very beneficial to businesses that operate as S Corporations. For our customers this is a very common business structure and these proposed changes would be welcomed. While few of our clients operate as a partnership those that do would also welcome most of the proposals. There are some proposed changes to payments made to partners that will require some change of thinking but as a whole these too would be beneficial for our clients.

As to option 2, I think it is important to say that this represents more of a radical change from the current tax structure. As we all know, change can be a scary thing for some people. I do have some concern about the proposal to require entity level withholding on income for the smallest of small businesses. For this group, withholding on payments to the partners instead of income would be simpler for them to comply. Also, option 2 could generate more in the way of transition rule issues. But this option would still be an improvement over the current system.

In conclusion, it is important to remember that policymakers should always try to strike a balance between tax compliance and taxpayer burden. For many small business owners that rely heavily on their business checking account for their basic books what might seem like good tax policy here in the halls of Congress will, and is, seen as needless burden to someone simply trying to make the next payroll. Chairman Camp's proposal definitely heads in the right direction for entrepreneurs looking for a simpler system that simplifies their life and lets them just focus on running and building their business. Thank you for this opportunity to testify today and Padgett Business Services looks forward to working with this Committee and the Committee on Ways and Means on this crucial issue.

For additional information on the Simplified Cash Method proposal, please see the following:

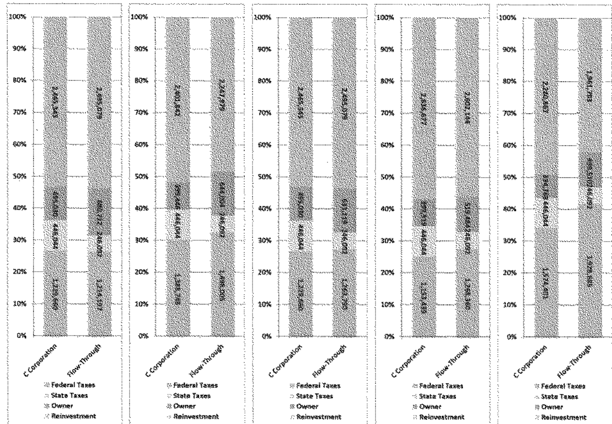
David Kautter and Donald Williamson, “A Simplified Cash Method of Accounting for Small Business” **Tax Notes,** February 13, 2012, pages 863–867.

General Accountability Office “TAX GAP - A Strategy for Reducing the Gap Should Include Options for Addressing Sole Proprietor Noncompliance” July 2007 GAO–07–1014

The Report of The President’s Advisory Panel on Federal Tax Reform, pages 94–96, 127–128

Annual Tax Liability on Manufacturing Entity & Owner - Summary
New England Company

	Current Law - 2011		Current Law - 2013		35% - Base Case		25% Case		39.6% - Worst Case	
	C Corporation	Flow-Through	C Corporation	Flow-Through	C Corporation	Flow-Through	C Corporation	Flow-Through	C Corporation	Flow-Through
Significant Inputs & Assumptions										
Adjusted Taxable Income	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597	4,653,597
Owner Wages/Bonuses	257,275	257,275	257,275	257,275	257,275	257,275	257,275	257,275	257,275	257,275
Distributions Paid	328,410	328,410	328,410	328,410	328,410	328,410	328,410	328,410	328,410	328,410
IC-DISC Commission	-	-	-	-	-	-	-	-	-	-
Owner's Itemized Deductions (except SALT)	300,000	300,000	300,000	300,000	300,000	300,000	300,000	300,000	300,000	300,000
Is LIFO repealed?	NO	NO	NO	NO	NO	NO	YES	YES	YES	YES
Domestic Producers Deduction (DPAD) Repealed?	NO	NO	NO	NO	NO	NO	YES	YES	YES	YES
Research Credit Repealed?	NO	NO	YES	YES	NO	NO	YES	YES	YES	YES
IC-DISC Benefits Repealed?	NO	NO	NO	NO	NO	NO	YES	YES	YES	YES
Itemized Deduction Phase-out Reinstated	NO	NO	YES	YES	YES	YES	YES	YES	YES	YES
Itemized Deductions Subject to a Tax Rate Limitation	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
Itemized Deductions Repealed?	NO	NO	NO	NO	NO	NO	YES	YES	YES	YES
Consider Depreciation Expense in Calculation?	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
Depreciable Property Placed In-Service	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879	11,571,879
Bonus Depreciation %	100.00%	100.00%	0.00%	0.00%	50.00%	50.00%	50.00%	50.00%	50.00%	50.00%
Maximum §179 Deduction	500,000	500,000	25,000	25,000	500,000	500,000	500,000	500,000	500,000	500,000
Minimum §179 Phase-out Limitation	2,000,000	2,000,000	200,000	200,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Maximum Corporate Income Marginal Rate	34.00%	34.00%	34.00%	34.00%	34.00%	34.00%	25.00%	25.00%	34.00%	34.00%
Maximum Individual Ordinary Income Marginal Rate	35.00%	35.00%	39.60%	39.60%	35.00%	35.00%	25.00%	25.00%	39.60%	39.60%
Federal Individual Dividend Preferential Rate	15.00%	15.00%	39.60%	39.60%	15.00%	15.00%	25.00%	25.00%	39.60%	39.60%
Federal Individual Capital Gain Preferential Rate	15.00%	15.00%	20.00%	20.00%	15.00%	15.00%	20.00%	20.00%	20.00%	20.00%
Unearned Income Medicare Surcharge	0.00%	0.00%	3.80%	3.80%	0.00%	0.00%	3.80%	3.80%	3.80%	3.80%
State & Local Income Tax - Entity Level	9.50%	0.00%	9.50%	0.00%	9.50%	0.00%	9.50%	0.00%	9.50%	0.00%
State & Local Income Tax - Owner Level	5.30%	5.30%	5.30%	5.30%	5.30%	5.30%	5.30%	5.30%	5.30%	5.30%
Millionaires Tax	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	3.00%	3.00%	3.00%	3.00%
Millionaires Tax Threshold	-	-	-	-	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Summary & Statistics										
Cash Used to Pay Federal Taxes	1,229,660	1,214,197	1,388,748	1,498,005	1,229,660	1,263,790	1,153,439	1,268,360	1,574,401	1,928,685
Cash Used to Pay State Taxes	446,044	246,092	446,044	246,092	446,044	246,092	446,044	246,092	446,044	246,092
Cash Retained by Owner	495,030	680,712	399,446	644,004	495,030	631,119	399,919	519,484	334,768	499,510
Cash Reinvested in Business	2,465,345	2,495,079	2,401,842	2,247,979	2,465,345	2,495,079	2,636,677	2,602,144	2,280,867	1,961,793
Total Cash Income	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080	4,636,080
% of Cash Used to Pay Federal Taxes	26.52%	26.19%	29.96%	32.31%	26.52%	27.26%	24.88%	27.36%	33.96%	41.60%
% of Cash Used to Pay State Taxes	9.62%	5.31%	9.62%	5.31%	9.62%	5.31%	9.62%	5.31%	9.62%	5.31%
% of Cash Retained by Owner	10.68%	14.68%	8.62%	13.89%	10.68%	13.61%	8.63%	11.21%	7.22%	10.77%
% of Cash Reinvested	53.18%	53.82%	51.81%	48.49%	53.18%	53.82%	56.87%	56.13%	49.20%	42.32%
Effective Tax Rate on Cash Income	36.14%	31.50%	39.58%	37.62%	36.14%	32.57%	34.50%	32.67%	43.58%	46.91%
Effective Tax Rate Change Compared to 2011 Law			3.43%	6.12%	0.00%	1.07%	-1.64%	1.17%	7.44%	15.41%
Effective Tax Rate Differential of Entity Structure	4.65%	-4.65%	1.96%	-1.96%	3.58%	-3.58%	1.83%	-1.83%	-3.33%	3.33%



we wear jobs

April 12, 2013

The Honorable Sam Graves
House Small Business Committee, Chairman
2361 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Graves,

On behalf of the American Apparel & Footwear Association (AAFA), the national trade association for apparel, footwear, and other sewn products companies and their suppliers, I am writing in support of the discussion draft on small business tax reform, authored by Chairman Dave Camp of the House Ways & Means Committee, which the Committee on Small Business is examining.

AAFA's 425 member companies account for over 1,000 brands and represent over 75% of the entire U.S. apparel and footwear industry. With over $350 billion in annual domestic sales and over 19 billion garments purchased in 2011, our industry is one of the largest consumer segments in the United States and sustains more than four million American jobs. This industry also includes a large portion of small businesses, whether they be retailers, brands, domestic manufacturers, or design shops.

It is extremely important small business is not forgotten in the push for corporate tax reform, and AAFA applauds the spirit of the discussion draft, and the efforts of the House Committee on Small Business. AAFA generally supports the provisions contained within the draft, particularly making permanent section 179 expensing at pre-stimulus levels, allowing businesses with gross receipts of $10 million or less to use the cash method of accounting, increasing the threshold for start-up expenses, and repealing the separate special rules relating to the organizational costs of corporations and partnerships. Provisions that AAFA would like to see worked on include allowing small businesses greater flexibility to decide on a deductible timeline for start-up expenses.

Again, thank you for your efforts to raise the needs of small businesses in the ongoing debate over comprehensive tax reform. AAFA hopes that the push for corporate tax reform for all U.S. businesses continues to see movement in the 113th Congress. We look forward working with the House Committee on Small Business on this important issue.

Thank you for this opportunity to submit comments. Please feel free to contact AAFA's Tax Policy Liaison, David Lapidus, at DLapidus@wewear.org, if you have any questions or need further information.

Sincerely,

Kevin M. Burke

Kevin M. Burke
President and CEO
American Apparel & Footwear Association (AAFA)

1601 North Kent Street
Suite 1200
Arlington, VA 22209

(703) 524-1864
(800) 520-2262
(703) 522-6741 fax
www.wewear.org

701 Pennsylvania Avenue, NW, Suite 800
Washington, DC 20004-2654
Tel: 202 783 8700
Fax: 202 783 8750
www.AdvaMed.org

April 15, 2013

Chairman Sam Graves
Ranking Member Nydia Velázquez
U.S. House Committee on Small Business
Congress of the United States
Washington, D.C. 20515

Dear Chairman Graves and Ranking Member Velázquez:

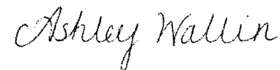
Thank you for providing the Advanced Medical Technology Association (AdvaMed) the opportunity to provide written testimony for the April 10, 2013 hearing on simplifying the tax code in support of small businesses.

AdvaMed represents the manufacturers of medical devices and diagnostics. Medical technology is a vital and dynamic knowledge-based manufacturing industry where America currently leads the world. Our leadership, however, is increasingly challenged, and America's uncompetitive tax code is a major impediment to continued location and growth of research and development and manufacturing in the United States – especially for pre-profitable companies.

Our written testimony is attached. As you move forward on tax reform with consideration of the impact to small businesses, please feel free to call on us for any additional information that would be helpful in your task.

Once again, thank you for providing us with this opportunity and for giving high priority to the important goal of assuring that the U.S. tax system supports a supportive and competitive environment for small companies focused on the development of transformative, life-changing new technologies.

Yours sincerely,



Ashley K. Wallin
Executive Director and Vice President
AdvaMed Emerging Growth Company Council

House Small Business Committee

Small Business Tax Reform: Growth through Simplicity
April 10, 2013

Testimony for the Record
Advanced Medical Technology Association (AdvaMed)

The Advanced Medical Technology Association (AdvaMed) appreciates the opportunity to provide written testimony for today's hearing on simplifying the tax code in support of small businesses. AdvaMed represents approximately 400 of the world's leading medical technology innovators and manufacturers of medical devices, diagnostic products and medical information systems. AdvaMed members range from the smallest to the largest medical technology innovators and companies – nearly 80% of our members are small companies in a pre-revenue state or with annual domestic sales of less than $100 million. AdvaMed is dedicated to the advancement of medical science, the improvement of patient care, and in particular to the contribution that high quality health care technology can make toward achieving those goals. We believe that changes to the tax code are essential to support continued creation and growth of the small start-up companies that are critical to the future of our industry and to other knowledge-based, high technology industries.

About the Medical Device Industry

The medical technology industry is an American success story. The industry directly employs more than 400,000 workers nationwide. Typically, for every worker our industry directly employs, another four workers are employed by businesses supplying components and services to our industry and our employees, so that the total numbers generated by our industry nears two million.

The jobs our industry provides are good jobs—the kinds of jobs that allow employees to live the American dream. Industry pay levels are 38 percent higher than average pay for all U.S. employment and 22 percent higher than other manufacturing employment. While the number of manufacturing jobs was plummeting across the larger economy, even before the recent economic downturn, employment in our industry was expanding. Between 2005 and 2007, medical technology employment grew 20.4%, adding 73,000 jobs. During the recession, between 2007 and 2008, MedTech employment dropped 1.1 percent, compared to 4.4% for manufacturing as a whole.

What the Committee may not know is that the medical technology industry is heavily skewed toward small companies—the kind of companies that begin with a scientist or doctor with an idea to improve patient care. Almost two-thirds of the 7,000 medical technology firms in the U.S. have fewer than 20 employees – the majority of these companies being in pre-revenue or early revenue stages. A high proportion of the breakthrough products in our industry come from these small, often venture-capital funded companies. The long-term health of the whole industry depends on the continued success of these small firms and their access to the capital necessary to develop the breakthrough products of the future.

With this being said, these emerging and early-growth companies are facing extreme drought in terms of required capital to develop new technologies and create new jobs. In 2012, venture capital investments in the Medical Device industry fell by 13% in dollars and 15% in deals – with a total of $2.4 billion going into 313 deals. Much of the decline occurred in first-time financings, where Medical Devices saw the lowest number of deals

since 1995.[i] Prior to the financial crisis of 2008, the industry began experiencing a significant decline in the number of first-time financings, as shown in Figure 1[ii]. Total investments have also declined to levels below those present prior to the financial crisis (Figure 2).

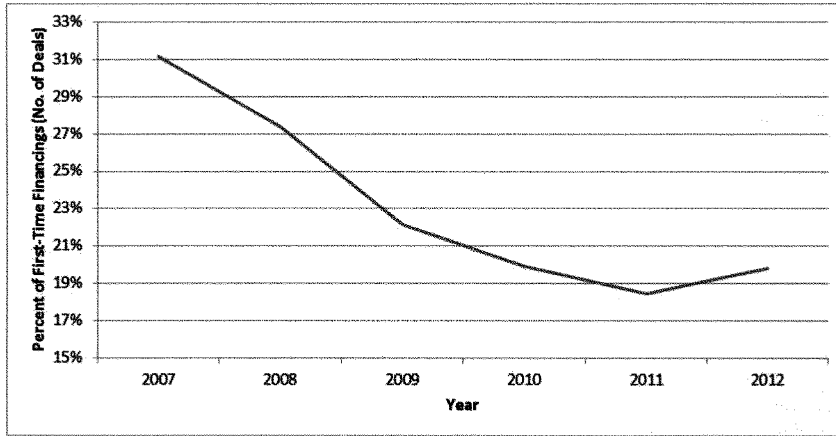


Figure 1. First-Time Investment Decline since 2007 (based on number of deals)[ii] – Medical Device Industry

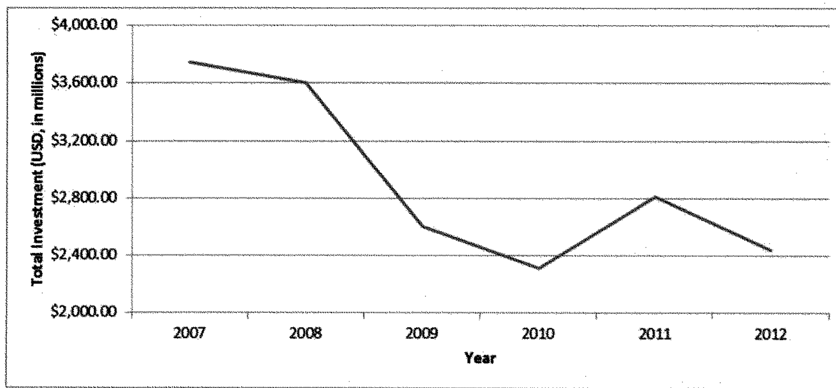


Figure 2. Total Venture Capital Investment in the Medical Device Industry[ii]

Whether a firm is large or small, success in our industry comes only from innovation—the creation of diagnostics, treatments and cures that extend and enhance lives. Our industry's investment in research and development is more than twice the national average. Our product life-cycle is typically only 18-24 months, so being able to invest in R&D is essential to creating the next generation of treatments and cures.

With $33 billion in total exports in 2008, medical technology ranks eleventh among all manufacturing industries in gross exports. Notably, unlike virtually every other sector of U.S. manufacturing, medical technology has consistently enjoyed a favorable balance of trade.

While we are very proud of our contributions to the U.S. economy, we are even more proud of our contributions to improving patient care. For patients, medical progress has been remarkable. Between 1980 and 2000, medical progress added more than three years to life expectancy. The death rate from heart disease was cut in half; the death rate from stroke was cut by one-third, and the death rate from breast cancer was cut 20%. Medical technology has been a major driver of this progress.

We have been able to make these contributions while helping to keep overall health care costs from growing. Our industry is so competitive that increases in costs for our products have averaged only one-quarter the rate of other medical goods and services and just one-half the general CPI for almost 20 years. Many of the devices produced by our companies help reduce hospital readmissions or address chronic disease, and in the long-term can provide cost-savings for the health care system through better patient outcomes.

But the continued success of our industry depends on the continued success of a vibrant and supportive environment for small companies, especially small, start-up companies that have not yet attained profitability.

Tax Reform: An Opportunity to Promote Innovation and Stimulate Investment in Emerging Companies

AdvaMed applauds Ways and Means Committee Chairman Camp and Chairman Graves, Ranking Member Velázquez, and the Small Business Committee for their consideration of small businesses as the tax code is reformed. Lowering the overall tax rate can make a vital contribution to the health and competitiveness of a small business. For the start-up small businesses that are so important to our industry, however, access to capital in the pre-profit stage is also crucial. Development of a new breakthrough product to point of FDA approval and marketing typically requires years and close to $100 million in investment, and companies generally do not reach profitability until they achieve annual revenues exceeding $100 million. We urge you to consider ways of adjusting the tax code to address the needs of these small, innovative, research-intensive businesses through incentives that encourage investments from other companies, individuals, and funds. Providing additional incentives for investment in these pre-profit companies is critical to encouraging their ultimate success and their ability to create new jobs and commercialize life-changing technologies.

"Broadening the base and lowering the rate," while desirable, is not by itself sufficient to support the establishment, survival, and growth of these companies, especially those not yet realizing a revenue stream. In addition to simplifying the tax code, comprehensive tax reform should also encourage current – and new – investors to finance companies sooner. With the new challenges posed by an increasingly demanding regulatory and payment environment, incentives in the tax code to encourage availability of capital for companies developing the life changing innovation and great products of the future are essential. To achieve this objective, AdvaMed believes that the following policies should be part of tax reform:

Device Tax Repeal

The 2.3% Medical Device Excise Tax poses an enormous burden for small companies – in terms of capital and compliance. From their first sale, these companies are subject to the tax, even with millions of dollars in net operating losses incurred over years of development. AdvaMed continues to advocate for full repeal of this detrimental tax burden.

Section 469 R&D Partnership Structures

AdvaMed, along with the Coalition of Small Business Innovators (CSBI), supports a limited exception from the passive activity loss (PAL) rules for R&D-focused pass-through entities. Relaxing the PAL rules will incentivize investors to finance companies at an earlier stage when capital is most needed – and where current investments in the Medical Device industry have dried up most since 2007.

Section 382 Net Operating Loss (NOL) Reform

AdvaMed, along with CSBI, supports the exemption of NOLs generated by qualifying research and development conducted by a small business from Section 382. Currently, the usage of NOLs by companies who have undergone an "ownership change" is restricted. Such reform would encourage additional outside financing and help make such businesses more attractive to investors.

Section 1202 Capital Gains Reform

AdvaMed, along with CSBI, supports changing the qualified small business (QSB) definition to include companies with gross assets up to $150 million (from $50 million), with that cap indexed to inflation. This change would also include S-Corps and LLCs in the definition of a QSB. Furthermore, AdvaMed and CSBI support excluding the value of a company's IP when calculating gross assets. These changes would also encourage investment into emerging and early-growth medical device companies.

Permanent Extension of Section 179 Depreciation Deduction

AdvaMed also supports the permanent extension of the Section 179 expense, which allows qualifying small business owners to deduct the cost of depreciating business assets on their tax returns at a limit of $500,000. Furthermore, AdvaMed supports the permanent extension of bonus depreciation in Year 1 (50% of cost) of a qualified business asset purchase. Such incentives allow companies to invest more heavily in their businesses and encourage job creation and growth.

Permanent Extension of Sections 992-996 IC-DISC Status

AdvaMed supports the permanent extension of IC-DISC status for qualified small companies exporting to other countries. Many medical device companies are forced to commercialize their products first overseas. The tax rate reduction to 15% provides these companies with capital to fuel organic growth, finance clinical studies and regulatory approvals in the United States, and develop new technologies.

Conclusion

In closing, we would like to thank Chairman Graves and Ranking Member Velázquez for their interest in the tax code's impact on small businesses and consideration of the proposals contained herein to support research and development-intensive firms. Our industry stands ready to work with the Small Business and Ways and Means Committees as you continue your efforts to reform the tax code, which will help provide the medical device and diagnostics industry the opportunity to continue be the world leader in the development of new technologies that allow patients to lead longer, healthier, and more productive lives.

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[i] Pricewaterhouse Coopers and NVCA, "MoneyTree Report," January 2013.

[ii] Thomson Reuters, MoneyTree Report Aggregate Data Q1 1995 – Q4 2012.

Promoting Innovation Through Tax Reform

The Coalition of Small Business Innovators (CSBI) supports a U.S. tax code that recognizes innovation as a crucial part of the 21st century American economy. By itself, a lower corporate tax rate will not support growth and innovation in America's small businesses, many of which are pre-revenue. Comprehensive tax reform should go further than "broadening the base and lowering the rate." Instead, policymakers should specifically promote innovative research-intensive businesses through incentives for other companies, individuals, and funds to invest in small companies and support their research.

Section 469 R&D Partnership Structures
Background: 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 high tech 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.

Proposal: CSBI supports a limited exception from the PAL rules for R&D-focused pass-thru entities. Under the High Technology Small Business Research Incentives Act, 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.

Section 382 Net Operating Loss (NOL) Reform
Background: 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 losses, which can be used to offset future gains if the company becomes profitable. However, Section 382 restricts the usage of NOLs by companies which have undergone an "ownership change." The law was enacted to prevent NOL trafficking, but small high tech companies are caught in its scope – their reliance on outside financing and deals triggers the ownership change restrictions and their NOLs are rendered useless.

Proposal: CSBI 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
Background: 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.

Proposal: CSBI supports changing the QSB definition to include companies with gross assets up to $150 million, with that cap indexed to inflation. CSBI 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 high tech research will increase the innovation capital available to research-intensive businesses and speed the development of groundbreaking technologies.

Statement of

The Associated General Contractors of America

to the

Committee on Small Business

U.S. House of Representatives

For a hearing on

"Small Business Tax Reform: Growth Through Simplicity"

April 10, 2013

Building Your Quality of Life

AGC is the leading association in the construction industry. Founded in 1918 at the express request of President Woodrow Wilson, AGC now represents nearly 30,000 leading firms in the construction industry through a network of 95 chapters throughout the United States. AGC members engage in the construction of buildings, shopping centers, factories, industrial facilities, warehouses, highways, bridges, tunnels, airports, waterworks facilities, waste treatment facilities, dams, hospitals, water conservation projects, defense facilities, multi-family housing projects, municipal utilities and other improvements to real property.

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
2300 Wilson Boulevard, Suite 400 • Arlington, VA 22201 • Phone: (703) 548-3118 • FAX: (703) 548-3119

Statement of

The Associated General Contractors of America

Committee on Small Business

United States House of Representatives

April 10, 2013

The Associated General Contractors of America (AGC) appreciates Chairman Graves for holding yet another hearing on the difficulties faced by small businesses when wading through the regulations and complexities of the Internal Revenue Code (IRC). Furthermore, AGC wants to commend the thoughtful progress that Chairman Camp, Ranking Member Levin, and the Members on the Ways and Means Committee are making towards comprehensive tax reform and welcomes the opportunity to comment on areas relating to small businesses as pass-through entities.

As part of the Ways and Means Committee's goal to strengthen the economy, crate more jobs and increase wages for American families by making the tax code simpler and fairer, Chairman Camp has directed over 20 tax hearings, released three draft legislative discussions to enhance the feedback to the committee and most recently organized bipartisan working groups to address specific areas of the tax code and more specifically, focusing on the small business community.

Since the beginning of his tenure at the helm of the Committee, Chairman Camp has exhibited a steadfast commitment to pursuing tax reform in a comprehensive manner. In fact, his first order of business was to chair a full committee hearing that addressed the complexity and broader cost to the U.S. economy of a tax system that fails to maximize job creation and impedes economic growth.

Early in the debate, Chairman Camp laid down the ground rules that the rates should be lowered to 25 percent in order to make the U.S. more competitive, and that reform should address the structure of both individuals and corporations in tandem. This is important, since more than three-quarters of small business pay taxes on business income at the individual rate.

AGC members are engaged in all forms of nonresidential construction and consist primarily of small businesses with the vast majority of our members (typically more than 70 percent when surveyed) organized as pass-through entities. When our members discuss tax reform they gravitate towards simplicity and permanency as being critical to tax policy. With a critical element of permanency being the indexing of income thresholds so that inflation is not the cause of tax policy changes.

AGC is the leading association in the construction industry. Founded in 1918 at the express request of President Woodrow Wilson, AGC now represents nearly 30,000 leading firms in the construction industry through a network of 95 chapters throughout the United States. AGC members engage in the construction of build-

ings, shopping centers, factories, industrial facilities, warehouses, highways, bridges, tunnels, airports, waterworks facilities, waste treatment facilities, dams, hospitals, water conservation projects, defense facilities, multi-family housing projects, municipal utilities and other improvements to real property.

While AGC and its membership continue to analyze the latest discussion draft released by the Ways and Means Committee on small businesses and pass-through entities; AGC would like to provide the following commentary on the impact of selected proposals on our construction company members and offer other areas for consideration.

Predictability for Business Operations

AGC appreciates the efforts by Congress to provide a significant amount of certainty to its membership through the passage of the American Taxpayer Relief Act (ATRA). The legislation that was signed in to law to avert the 2012 fiscal cliff permits companies to plan with the greater confidence that comes from cost predictability. AGC is particular pleased with the permanent extension of the 2001 and 2003 tax cuts for 98 percent of Americans.

AGC is also appreciative for the certainty provided for marginal rates for long-term capital gains and dividends set at 15 percent for earnings below $400,000 ($450,000 for joint filers) and 20 percent taxable incomes above the aforementioned amounts; as well as the increase in the Alternative Minimum Tax (AMT) exemption amount, exemption phase-out threshold, and indexing for inflation.

Another priority for AGC members if the planning for transfer of ownership after the passing of an owner. ATRA allows family-owned businesses within the AGC membership to focus on growth and business planning; which would grow our economy, create new jobs, and strengthen businesses. For this reason, AGC is grateful for the reasonable, permanent reform provided under the new law with a 40 percent tax rate for estates above the exemption value of $5 million indexed for inflation ($5.25 million for 2013).

Small Business Provisions

179 Expensing

While ATRA allows Section 179 expensing levels to increase to $500,000, the limit on what a business can deduct is slated to decrease to a meager $25,000 in 2014. AGC supports Chairman Camp's discussion draft provisions regarding the permanent nature of the Section 179 expensing of new equipment and property up to $250,000 phasing it out at $800,000 and indexing the amount to inflation. AGC continues to study the impact on the construction industry of phasing-down from the $2,000,000 to $800,000 level.

In addition, we recommend making two changes to current law that could provide additional flexibility and simplicity to construction industry tax compliance.

Lookback Accounting

The Tax Reform Act of 1986 revised the long-term contract accounting rules for contractors. These rules—contained in Section

460 of the IRC—require a construction contractor to file amended tax returns for every prior year in which a currently completed contract was in progress. For small and mid-size contractors, look-back computations are very complex and expensive, requiring inordinate amounts of time, resources and accounting fees to comply, with the results usually being confusing and immaterial to both the government and the taxpayer. Since this process is pushed down to the individual shareholder level, a company must go through each individual's returns to make the interest computation. These recalculations can go back a number of years. In the end, the same tax is paid.

Currently, Section 460(b)(3)(B) provides an exemption from the look-back rules for contracts which are completed within two years and for which the contract price does not exceed the lesser of $1,000,000 or 1 percent of the average gross receipts of the taxpayer for the three preceding years. A legislative change to exempt long-term contracts spanning 36 months at a $25,000,000 threshold would exempt a significant percentage of the small and mid-size construction contracts currently subject o look-back. According to AGC data, approximately 95 percent of construction contracts are completed in two years or less. For construction companies, most contracts are fulfilled in under 36 months.

AGC believes that a legislative change exempting closely-held pass-through entities under a 36 month timeframe would significantly reduce the compliance burden on these taxpayers by averting thousands of dollars spent on tax practitioners to make the interest calculations; as well as diminish the enforcement burden for the Internal Revenue Service, with no measurable effect on revenue. AGC advocates that this modification to lookback accounting should encompass business of all sizes and tax structures to include pass-throughs, as well as C-corporations.

Employment Taxes

There have been a number of proposals put forth to address the treatment of employment taxes currently afforded to pass-through entities. S-corporation flow-through income has historically had an employment tax advantage over that of sole proprietorships, partnerships and limited liability companies (LLCs). An S-corporation shareholder's undistributed share of S corporation income is not treated as self-employment income. Alternatively, earnings attributed to a sole proprietor, general partner or many LLC members are subject to self-employment taxes; although Section 1402 excludes from self-employment income a limited partner's distributive share of partnership income. Some proposals that have been introduced would eliminate that exclusion for any partner with a higher adjusted gross income.

AGC believes that proposals to modify or unify rules for pass-through entities should be fully vetted by the Ways and Means Committee in an open and transparent manner with continued significant input from stakeholders. A brash attempt to treat taxation of S-corporation shareholders the same as partnerships, thus exposing 100 percent of earnings to a potential Social Security or Medicare tax would be a significant departure from the current

structure of these entities and it would distort the tax liability of certain corporate structures.

Comprehensive Reform for Both Entities

AGC believes that Congress should continue the dialogue of comprehensive tax reform at both the individual and corporate levels simultaneously. The individual and corporate codes are not mutually exclusive and they must be reformed while discussing the reactionary affect a policy change would have on each other structure. Pass-through entities account for some 90 percent of businesses, employ more than 50 percent of the private sector workforce and report more than a third of all business receipts. Like corporations, pass-through organizations face nearly the highest rate among industrialized countries on business income. Under the individual code, pass-through entities face a top marginal rate of 39.6 percent, even higher than the anti-competitive 35 percent rate faced by C-corporations.

Moreover, changes to the IRC under the Patient Protection and Affordable Care Act (PPACA) only exacerbate the tax burden on pass-through businesses. The law increases the Medicare Part A (hospital insurance) tax rate by 0.9 percent on unearned income on earnings over $200,000 for single filers or $250,000 for joint filers, and imposes a 3.8 percent tax on investment income for taxpayers with a modified adjust gross income (MAGI) exceeding $200,000 for single filers or $250,000 for joint filers. Including the healthcare tax increase, marginal rates will be set at 40.5 percent for individuals earning over $400,000 and 40.5 percent for joint filers earning over $450,000.

If Congress ultimately pursues a reform that eliminates deductions and credits for a lower corporate rate, many small businesses would experience an increase in the income taxes paid as individual owners of a pass-through business. For the aforementioned reasons, AGC strongly recommends that tax reform be pursued comprehensively, addressing both individual and corporate tax rates.

Conclusion

AGC thanks the Members of the Small Business Committee for the opportunity to submit comments on areas regarding small business/pass-throughs during this period of fact-finding for comprehensive tax reforms. We believe strongly that an overhaul of the IRC must deal with all business structures similarly and contemporaneously. We believe that simplicity and certainty should be the goal of tax reform and that provisions in the existing code that create a compliance nuisance with little or no change in tax liability should be eliminated especially for small businesses.

AGC looks forward to ongoing consultation with Congress, the Committee, and Members of the Working Groups as this process continues to make improvements to the code in order to create an atmosphere that is increasingly pro-business and pro-growth.

Submitted via Electronic Mail

April 8, 2013

The Honorable Sam Graves
Chair of the House Small Business Committee
2361 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Graves:

AAHomecare is the national trade association representing providers and manufacturers of durable medical equipment, prosthetics, orthotics and supplies (DMEPOS) used by Medicare beneficiaries in their homes. We are pleased to submit this letter commenting on the proposed Tax Reform Act of 2013 discussion draft.

A Choked Industry
Durable medical equipment (DME) providers are a unique segment of the small business market. Unlike many other small businesses, which with adequate capital can open a store front and begin offering goods and services, DME providers must adhere to state licensing requirements, obtain surety bonds, and follow all Medicare and Medicaid standards including accreditation standards. Providers who wish to sell to Medicare and Medicaid beneficiaries must also submit to scrutiny by The Centers for Medicare and Medicaid Services (CMS) as well as state Medicaid program. In addition to the costs associated with simply opening a DME company, many providers have invested significant money and time in training, licensing, and further accreditation so they can offer specialized services for respiratory or mobility patients.

Once a DME company is established, they face additional constraints on their ability to get reimbursed or paid by Medicare for the equipment and associated services provided to their patients. To quote an AAHomecare member, "because CMS can audit claims from 5 years back, I can't count as income money that isn't safely mine for 5 years." Such harsh tactics remove any incentive providers have for innovation, and make supplying equipment and the invaluable services that come with the equipment extremely difficult. Like all industries, ours seeks to innovate to be able to provide high quality goods and exceptional services to patients, at the best price. Audits are only one of the major barriers to innovation; our industry is being squeezed by the competitive bidding program developed by CMS. This program, which has little oversight, has become less about competition, and more about administrative pricing designed to shove local providers out of business.

1707 L Street, NW, Suite 350, Washington, DC 20036
Tel: 202-370-0107 fax: 202-835-8306 www.aahomecare.org

Page 2
April 8, 2013

Innovative Providers Seeking Relief
AAHomecare supports any effort to alleviate the tax burden on DME providers that encourages innovation. AAHomecare members have worked to streamline their business, innovate how services are delivered, and develop business systems to ensure that their patients are provided with the highest quality equipment and services. Innovation has been and will continue to be crucial for DME providers to maintain their businesses in the wake of harsh regulatory demands.

Thank you for your time and attention to our concerns. We very much appreciate the opportunity to submit this letter. Please feel free to contact me if you have any questions.

Sincerely,

Tyler Wilson
President and CEO of AAHomecare

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

March 22, 2013

Chairman Dave Camp
House Ways and Means Committee
341 Cannon HOB
Washington, DC 20515-2204

Dear Chairman Camp:

I want to take this opportunity to thank you for including language in your draft small business tax bill that would make permanent the Sec. 179 expensing provision in existing statute. The ADA believes this is a major issue affecting dental practices, both as small businesses and as providers of care.

Your bill would continue to allow small businesses to deduct immediately investments in new equipment and property up to $250,000, with the deduction phased out on investments exceeding $800,000. If Congress does not act to make this provision permanent, those levels will revert back to pre-stimulus levels of $25,000 and $200,000, respectively. Without the incentive the current law provides, many of our members would find it more difficult to purchase the equipment necessary to deliver the high-quality dental care patients in this country have come to expect from their dentists.

This section of your bill can help ensure that small businesses continue to contribute significantly to the economic health of the nation.

Thanks again for this and for everything you do.

Sincerely,

Robert A. Faiella, D.M.D., M.M.Sc.
President

RAF:rr:tjd

Statement of the American Farm Bureau Federation

Statement for the Record
House Committee on Small Business
Small Business Tax Reform: Growth through Simplicity
April 10, 2013

Presented by: Bob Stallman, President

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

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 system should be simple, transparent, revenue-neutral, repeal the Alternative Minimum Tax and be fair to farmers and ranchers. We commend the Committee on Small Business for holding a hearing on the impact of tax reform on small business and on the Committee on Ways and Means discussion draft on small business tax reform.

Any tax reform proposal considered by Congress must be comprehensive and include individual as well as corporate tax reform. The most common form of farm ownership is sole-proprietor, which accounts for 86.5 percent of all farms and 50 percent of sales. Partnerships comprise 7.9 percent of farm operations and 20 percent of sales. Incorporated farms, both C-corps and S-corps, comprise 4.4 percent of farms but account for 30 percent of sales with the vast majority of these farm corporations being family-held. In total, more than 96 percent of farms and 75 percent of farm sales are taxed under the provisions of the Internal Revenue Code provisions affecting individual taxpayers. (USDA 2007 Census of Agriculture).

Because many business deductions and credits are used by both corporate and pass-through businesses, their elimination in exchange for corporate-only rate reduction will result in a tax increase for the vast majority of farmers and ranchers who pay taxes as individuals. One example is the domestic production expense deduction, which amounts to an average $8,926 deduction per eligible farm household. (USDA Economic Information Bulletin Number 107, February 2013). Thus, any tax reform proposal that fails to reform the individual tax code will not help, and more likely hurt, the bulk of agricultural producers.

The loss of business tax deductions could also disadvantage family farm businesses that operate as C-corps because they tend to be small and already pay taxes on the lower side of the corporate rate scale. Just as with non-incorporated farms and ranches, they would be hurt by the loss of deductions but would not benefit completely from reduced corporate tax rates. In particular, the 15 percent bracket for corporations with taxable income of up to $50,000 should be retained and expanded, so that the income level is indexed for inflation using 1986 as a base.

SMALL BUSINESS DISCUSSION DRAFT PROPOSALS

Farmers Need Tools Like Cash Accounting to Deal with the Uncertainties of Agriculture

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 unless they are allowed to take advantage of tax tools to even out taxable income. Cash accounting combined with the ability to accelerate expenses and defer income gives farmers and ranchers the flexibility to manage their tax burden on an annual basis by allowing them to target an optimum level of taxable income. In addition, cash accounting allows farmers and ranchers to improve cash flow, reduce the

need to incur debt, simplify record keeping and offer an accurate reflection of a farmer or rancher's financial situation since cash accounting records revenue and expenses when they occur.

Cash accounting tools important to farmers and ranchers include the deferral of commodity and product receipts and prepaying the cost of livestock feed, fertilizer and other farm supplies. The option to prepay input costs gives farmers and ranchers the flexibility they need to plan, make major investments in their businesses and in many cases provides guaranteed availability of some agricultural inputs. This is especially important because farm production expenses are rising with 2013 costs forecast to be 5.7 percent higher than 2012 and 42 percent higher than the 2002 through 2011 average. Farm Bureau supports the continuation of unrestricted cash accounting for farmers and ranchers who pay taxes as individuals and cautions against reducing the number of corporate farms eligible to use it.

Another important tool that farmers and ranchers use to reduce income swings and to manage tax liabilities is farm income averaging. In 2004, according to IRS tax data, 50,800 farmers reduced their tax liability on average by $4,434 with income averaging. (USDA Economic Information Bulletin Number 107, February 2013). This provision would be even more valuable to farmers and ranchers if the averaging period were extended. Farm Bureau recommends that farmers and ranchers be allowed to average income over a five year period instead of the current three year period and have the flexibility to determine how much eligible farm income to assign to a specific prior year.

Expensing is Important to Capital-Intensive Businesses like Agriculture

Because farming requires large investments in machinery, equipment and other depreciable capital, farmers and ranchers place great value on tax code provisions that allow them to write off capital expenditures in the year that purchases are made. Tax provisions that accelerate expensing and depreciation allow farmers and ranchers to better manage cash flow, minimize tax liabilities and reduce borrowing. The ability to immediately expense capital purchases also offers the benefit of reducing the record-keeping burden associated with the depreciation.

The share of farm assets attributable to machinery and farm-use motor vehicles currently makes up 5.6 percent of total assets owned by farmers and ranchers and the percentage is growing. According to 2010 USDA Agricultural Resource Management Survey data, capital investments averaged $32,000 for those making investments. But averages don't tell the whole story. In a year when a farm business makes a major purchase (for example, a combine for $350,000 or a tractor for $200,000), business expenditures will spike. Of special significance to farmers and ranchers is the ability to use Sec. 179 Small Business Expensing. Because farmers and ranchers make single large purchases, Farm Bureau supports maintaining the $500,000 Sec. 179 small business expensing limitation and not reducing the $2 million acquisition limit. Farm Bureau also supports allowing farmers and ranchers to use bonus depreciation; expense soil and water conservation expenditures; deduct the cost of raising dairy and breeding cattle; deduct fertilizer and

soil conditioner costs; deduct the cost of raising timber; depreciate single purpose ag structures over shorter lives; and deduct reforestation expenses.

Section 263A Unicap Rules Should Be Simplified

Uniform capitalization rules are complex and a record keeping burden for those who grow plants for resale and who grow perennial crops. A grower must include certain direct and indirect costs in the basis of property and then recover these costs through depreciation or at the time of sale when there is a preproductive period of more than two years. Farm Bureau supports excluding businesses with less than $10 million of average annual gross receipts from the uniform capitalization rules as proposed by the Ways and Means Committee small business discussion draft.

Since the Ways and Means Committee discussion draft proposes to eliminate Section 263A requirements for businesses with gross receipts less than $10 million, farmers and ranchers should be allowed to use the same depreciation methods as other taxpayers. In 1987, in a compromise allowing producers of livestock an exception from Unicap requirements, all farm producers were restricted from using the 200-percent declining balance method of depreciation. With the elimination of Section 263A for the vast majority of farmers, the policy reason for limiting farm depreciation methods is moot.

INCOME TAXES

Lowering Rates Alone, While Important, May Not Benefit Farm and Ranch Businesses

While broadening the base and lowering the tax rate is important to any tax reform effort and is supported by Farm Bureau, it must be noted that lowering rates will impact farm and ranches differently than other businesses. While farm and ranch expenses continue from year to year with some variation, this is not true for farm income. Whether caused by unpredictable weather that affects crop yields or uncontrollable markets that set the price of goods sold, it is not uncommon for farmers and ranchers to have years with little or no taxable income. USDA reports that, based on IRS data, nearly three of every four farm sole proprietors reported a farm loss in 2010 and that since 1980 farm sole proprietors as a group have reported negative aggregate net farm income for tax purposes. About half of farm partnerships and small business corporations also report losses. (USDA Economic Information Bulletin 107, February 2013.) Thus, a lower individual rate may not adequately compensate farmers for lost tax provisions and over time could result in a higher effective tax rate. Allowing an unused deduction or credit to be carried backwards can provide an immediate benefit while carrying forward provides a delayed benefit. To accommodate the tax anomaly, Farm Bureau recommends that farmers and ranchers be allowed to apply the tax benefits of excess deductions and credits to previous and/or future tax years.

Capital Gains Taxes Continue to Plague Farmers and Ranchers

Capital gains taxes continue to be a problem for farmers and ranchers even though Congress enacted a permanent 15 percent tax rate for taxpayers making less than $400,000 (single person)/$450,000 (couple). Farming and ranching is a capital-intensive business that requires a large investment in land and buildings that are held for long periods of time. In fact, farm real estate assets account for 85 percent of a farmer or rancher's assets and on average, farmers own their farmland for 30 years, during which time land values can more than triple. In addition to capital gains taxes imposed when land and buildings are sold, proceeds from the sale of cattle used for breeding, dairy, draft and some other livestock are treated as capital gains income.

Raising capital gains tax rates would increase taxes on a significant portion of farm income. In 2010, about 38 percent of farmers, defined as taxpayers who filed a schedule F, reported some capital gains, nearly three times the share for other taxpayers. The average amount of capital gain reported by famers was almost more than double the average capital gain reported by other taxpayers. In 2010, capital gains income amounted to 21.5 percent of total taxable income reported by farm households. If capital gains are taxed at rates equal to income tax rates, farmers will face higher tax liabilities on capital gains income, even if ordinary tax rates are reduced. (USDA ERS Economic Information Bulletin Number 107, February 2013)

Capital gains tax rates are now permanently set at 15 percent for taxpayers making under $400,000 (single person)/$450,000 (couple). Taxpayers over the threshold pay capital gains taxes at a 20 percent rate. In addition, the new 3.8 percent Medicare Contribution Tax on unearned income collected when a taxpayer's income exceeds $200,000 individual/$250,000 couple is collected on top of regular capital gains taxes. The capital gains tax rate that farmers and ranchers will pay will almost always be at the higher levels because income will spike and can easily exceed the thresholds in the year that a farmer or rancher sells land. The higher rate will be imposed even though a farmer's or rancher's average annual income would not have exceeded the thresholds. For these reasons, Farm Bureau supports eliminating capital gains taxes and, until that can be accomplished, supports cutting the capital gains tax rate. Farm Bureau also supports repealing the Medicare Contribution Tax.

Capital gains taxes that come due when farm or ranch land owners sell land and buildings can influence the price and availability of farmland. With the average age of today's farmer at 58 years old, many farmers will consider retirement. As they do, they set the selling price of land or other assets high enough to recover the cost of capital gains taxes. This increases the likelihood that farmland will be developed for other uses since few young farmers can afford to buy from a retiring producer, creating an additional barrier to entry for young farmers and ranchers to get in to agriculture. For this reason, Farm Bureau supports a capital gains tax exclusion for the sale of agricultural land that remains in production or when a family business is transferred between parents and children.

The capital gains tax can also contribute to "land lock", a situation that occurs when a farmer or rancher chooses to maximize assets for retirement by holding onto land and buildings rather than selling them, paying the capital gains tax and investing the balance

in other retirement vehicles. While this does keep land in agriculture, it also prevents the transfer to farmers or ranchers wanting to start or expand their businesses. This is of special concern to young farmers and ranchers who said in a recent AFBF survey that securing adequate land to grow crops and raise livestock was their top challenge.

Capital gains taxes amount to a "retirement tax" on agricultural producers and are unfair to those who invest in their businesses rather than traditional retirement vehicles. Farmers and ranchers typically prepare for their senior years by reinvesting farm and ranch profits back into their businesses with the anticipation of selling assets to fund retirement. For this reason, Farm Bureau supports allowing a taxpayer to defer taxes from the sale of property and machinery by investing the proceeds into a retirement account with taxes due at withdrawal.

The capital gains tax also impacts the ability of ongoing farms and ranches to remain efficient and profitable and to be responsive to market signals from American and overseas consumers. Because capital gains taxes are imposed when buildings, breeding livestock and farmland are sold, it is more difficult for producers to shed unneeded assets to generate revenue to adapt and upgrade their operations. For this reason, Farm Bureau supports the indexing of assets for inflation.

Renewable Energy Tax Incentives are Important to Farmers and Ranchers

Agricultural production consumes large amounts of energy directly through products such as farm diesel or gasoline which can be highly sensitive to global uncertainty. Fuel and energy expenses now constitute more than 7 percent of a typical agricultural producer's production expenses. As energy consumers, Farm Bureau members support policies that will create a diverse, domestic energy supply to fuel America's economic growth and prosperity while strengthening our energy security.

As producers of energy, Farm Bureau members believe that a significant part of our nation's energy should come from the development and use of renewable energy sources such as ethanol, biodiesel, biomass, solar and wind. These sources are critical to our nation's energy future and will help further strengthen the overall national security of the United States. Renewable energy sources also contribute to the stability of the rural economy by creating another source of income for our nation's farmers and ranchers. For these reasons, we support tax incentives for biodiesel, biomass fuels and wind energy so that fledgling industries can develop economies of scale. In addition, we support tax incentives to expand the distribution infrastructure for renewable fuel so that it is readily available to consumers.

Other Provisions that are Important to Farmers and Ranchers

The vast majority of farmers and ranchers are self-employed and as such are able to take a 100 percent deduction for the health insurance premiums they pay against their income taxes. According to the USDA Economic Information Bulletin Number 107, February 2013, the average deduction for farm families using the deduction amounts to $6,173.

Farm Bureau supports continuation or this deduction and recommends that it be expanded so that a deduction can also be taken against self-employment taxes.

Farmers and ranchers pay a disproportionate amount of their income in property taxes because the value of their business is land-based and thus more subject to the real property tax than other businesses and individuals. Because the size of a real property tax bill is based on the value of the land owned and not the amount of money earned on that land, it is not linked to the landowners' ability to pay. This can create special hardships for farmers with land but relatively low cash flow. For this reason Farm Bureau supports the continuation of the deduction for local and state property tax paid on business assets and income.

The domestic production activities deduction (Section 199) is designed to encourage domestic production and production-related activities and includes the farm and ranch businesses. However, restricting the deduction to 50 percent of wages paid limits applicability to farmers and ranchers who produce labor-intensive commodities such as fruits, vegetables and milk. Reducing or eliminating the domestic activities deduction would result in a significant increase in taxable income for all farms that currently employ non-family labor. On the other hand, the benefit of the deduction would increase if agricultural producers were able to count wages paid as non-cash wages, such as crop share payments of commodities, and wages paid to their children working on their farms.

Farm Bureau supports a deduction for charitable contributions. Our members believe that charities play a valuable role in providing services to those in need in our communities and that people in need will be harmed the most if charitable giving is curtailed. Studies indicate that donors give for many reasons. While Americans do not make charitable gifts only for tax reasons, tax incentives make more and larger gifts possible. This is true for two tax provisions of special interest to farmers and ranchers that are set to expire at the end of this year.

Some farmers and ranchers already donate gleaned food to charity. Many more would do so if they were able to bear the costs of harvesting, processing and transporting surplus food. Unfortunately, when growers can't afford the expense of getting food from the field to the food bank, all too often it is left in the field or orchard. Farm Bureau believes the charitable deduction that allows non-C corporations to take a deduction for donating food should be made permanent and the deduction should be expanded so that farmers who use cash basis accounting could also take advantage of the deduction. The current deduction expires at the end of 2013.

The enhanced deduction for donating conservation easements to preserve farmland is of particular interest to farmers and ranchers. The current deduction has been temporarily expanded to raise the maximum deduction a donor can take for donating a conservation easement and to increase the number of years over which the deduction can be taken. More farmland owners would be willing to protect their farmland from development if the deduction is made permanent and if they are able to take a deduction akin to the reduced value of their property. The current deduction expires at the end of 2013.

ESTATE TAXES

Estate Taxes Remain a Concern for Farmers and Ranchers

While some consider estate taxes outside the boundaries of fundamental tax reform, the issue continues to be one of the most worrisome tax issues facing farmers and ranchers. Individuals, family partnerships and family corporations own 98 percent of our nation's more than 2 million farms and ranches. The value of family-owned farms and ranches is usually tied to illiquid assets, such as land, buildings and equipment. With 85 percent of farm and ranch assets illiquid, producers have few options when it comes to generating cash to pay the estate tax. When estate taxes exceed cash and other liquid assets, surviving family partners may be forced to sell land, buildings or equipment needed to keep their businesses running. This not only can cripple a farm or ranch operation, but also hurts the rural communities and businesses that agriculture supports.

Farm Bureau commends Congress for enacting permanent estate tax law that provides for a $5 million per person exemption indexed for inflation, the transfer to the spouse of any unused exemption amount and the continuation of the step-up in basis. However, with agriculture cropland values increasing on average 15 percent from 2011 to 2012, more and more farms are in danger of topping the exemption and estate tax planning continues to be complex and expensive for those close to or over the threshold. Farm Bureau continues to believe that estate taxes should be eliminated. Until permanent repeal is achieved, the exemption should be increased and indexed to inflation. We also support an increase in the gift tax exemption and indexing it for inflation.

Stepped-up Basis is Important to Farmers and Ranchers

Continuation of stepped-up basis at death is also very important to farmers and ranchers. Under stepped-up basis, a decedent's beneficiaries inherit assets with a basis for computing depreciation and capital gains equal to the fair market value of the assets on the date of the decedent's death. If the assets are sold by the heirs, capital gains taxes are only due on the increase in value since the property was inherited. One historical reason for the basis adjustment rules is the perceived unfairness of imposing a double tax on a beneficiary who inherits assets, first an estate tax, and then a capital gains tax when the executor or beneficiary subsequently sells the asset, especially if the sale was necessary to raise money to pay the estate tax. Additionally, there are practical concerns about calculating the basis for very long-held assets where the purchase price might be unknown and basis adjusting expenditures are difficult to substantiate. Farm Bureau supports the continuation of full unlimited step up in basis.

An Expanded Sec. 2032A Would Benefit Farmers and Ranchers

Special Use Valuation (Sec. 2032A) provides a valuable estate tax planning tool for farmers and ranchers who live in high land value areas. Sec. 2032A gives farmers, ranchers and other business owners the ability to reduce their estate taxes by allowing a

limited amount of business property to be valued for its actual use rather than for its highest value use for estate tax purposes. For example, farmland could be valued at its farm value rather than what it would be worth if sold for development. Many farmers and ranchers are, however, reluctant to use Sec. 2032A because of its limited benefits, because there are significant penalties imposed when the terms of its use are violated and because of its complex nature.

More family farms and ranches could be protected from estate taxes if Section 2032A were expanded and certain transfers were allowed. Currently, the value of property may not be reduced by more than $1 million indexed for inflation. This means that if the value of a farm for development purposes was $8 million and the farm value was $5 million, the use value assigned to the property under 2032A for estate tax purposes would be $7 million. There is also a restriction that says that part or all of the tax savings from using 2032A must be paid back if, within ten years, there is a sale of a conservation easement or if timber is sold off the property. Farm Bureau supports removing the limitation on the amount that property value can be reduced for use value under sec. 2032A and supports eliminating the recapture tax for timbering or selling a conservation easement.

AIA

The American Institute of Architects Statement for the Record

"Small Business Tax Reform: Growth through Simplicity"

U.S. House of Representatives
Committee on Small Business
April 10, 2013

The American Institute of Architects (AIA) appreciates the opportunity to provide a statement to the Committee on Small Business on the impact of tax reform on small businesses, and we commend the Committee for discussing this important issue.

The AIA has been the leading professional membership association for architects and allied partners since 1857. The AIA represents more than 81,000 architects and emerging professionals nationwide and around the world.

The AIA 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. We are hopeful that, at the end, tax reform is an opportunity to provide taxpayers with much-needed certainty, simplicity, and fairness, while at the same time encouraging economic growth and job creation.

U.S. architects are the leading edge of a design and construction industry that accounts for one in nine dollars of Gross Domestic Product. Every $1 billion invested in design and construction creates 28,500 full-time jobs in a wide range of industries. In 2011 alone, the 17,500 architecture firms owned by AIA members grossed billings of $26.0 billion, driving economic activity and job growth.

Architecture is by-and-large a small-business industry: most architecture firms at which AIA members work are small businesses. Approximately 97 percent of firms meet the Small Business Administration's size standard definition of a small business and have fewer than 50 employees. Moreover, a significant portion of these firms are organized as pass-through entities, including partnerships and S corporations. Many architects operate as sole proprietors, including a large number who lost their jobs in the recent economic crisis and set up shop on their own.

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

In addition to architects, every day, nearly 70 million Americans go to work at small businesses organized as something other than a C corporation. These "flow-through" businesses, structured as S corporations, partnerships, LLCs, or sole proprietorships, represent 95 percent of all businesses, and they contribute more to our national income and our job base than all the C corporations combined.

Despite these contributions, recent press reports suggest that the Administration and some Members of Congress support budget-neutral legislation that would reform the tax code for C corporations only. The proposal would be to reduce the tax rate on C corporations and offset those lower rates by eliminating or reducing tax deductions and credits used by all businesses.

Two years ago, Ernst & Young studied what "budget neutral, corporate-only" tax reform would mean to pass-through businesses. According to the Ernst & Young study, this approach would increase taxes on pass-through job creators of all sizes by at least $27 billion per year. In other words, corporate-only tax reform means lower taxes for large multinational corporations and higher taxes for small businesses like architecture firms.

"Corporate-only" tax reform would leave pass-through entities at a severe disadvantage, harming small businesses, including architecture firms. As Congress moves forward with tax reform, tax policies aimed at strengthening small businesses-- including tax policies that maintain the ability of businesses to choose pass-through forms of entities -- should be preserved.

We appreciate the House Ways and Means Committee's release of the Small Business Tax Reform Discussion Draft. We continue to analyze the impact that the Discussion Draft's proposals would have on AIA members.

In the meantime, we urge Congress to preserve tax policies that are aimed at strengthening small businesses, reducing compliance burdens, and providing certainty. Such policies would help spur economic activity by helping small businesses expand operations and drive job creation by allowing small businesses to hire new workers and increase wages and benefits.

We welcome the opportunity to provide this statement to the Committee and look forward to working with the Committee to foster an economic environment that helps small businesses grow our economy.

American Public Power Association

Ph: 202.467.2900
Fax: 202.467.2910
www.PublicPower.org

1875 Connecticut Avenue, NW
Suite 1200
Washington, DC 20009-5715

Statement

Of the

AMERICAN PUBLIC POWER ASSOCIATION

Submitted to the

HOUSE SMALL BUSINESS COMMITEE

For the April 10, 2013, hearing on

"Small Business Tax Reform: Growth through Simplicity"

(Submitted April 12, 2013)

The American Public Power Association (APPA) appreciates the opportunity to submit this statement in relation to the House Small Business Committee's April 12, 2013, hearing on "Small Business Tax Reform: Growth Through Simplicity." APPA is the national service organization representing the interests of over 2,000 municipal and other state- and locally-owned, not-for-profit electric utilities ("public power utilities") throughout the United States (all but Hawaii).

Our members serve some of the nation's smallest towns—roughly four out of five public power utilities serve 10,000 or fewer customers—and all but 43 meet the Small Business Administration standard for a small business.[1] These small utilities provide power to nearly 10 million residences, 1.7 million businesses, and 112,000 industrial customers. All told, nearly 26 million Americans receive their power from these small businesses.

Fundamental income tax reform could have a direct effect on a number of issues of concern to our members, including the treatment of health care expenses and of pension and retirement contributions and accruals. However, given the potential damage that could be done to our members' ability to continue their mission—to provide affordable and reliable electricity to their customers—this statement will focus primarily on the effect of tax reform on financing of capital expenditures.

As you know, one of the greatest challenges facing any small business is access to capital. This is the reason why small business loans and grants are among the top priorities of the Small Business Administration.[2] However, APPA members, as governmental entities, do not qualify for such loans and grants and must rely, instead, on municipal bond issuances for financing.

As a result, as Congress debates tax reform, it should consider carefully the effect on state and local governmental entities', including public power utilities', ability to rely on municipal bonds. This investment tool is critical to our members as small businesses, but also to our customers—many of which are small businesses themselves—who rely on us to make the infrastructure investments needed to

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[1] 12 CFR Part 121.201 *n.* 1 (referencing 4 million megawatt hours of sales or generation as the size standard for utilities in the Electric Power Generation, Transmission and Distribution Industry Group of the North American Industry Classification System).

[2] Providing guidance on staring and managing a small business, on how to secure federal contracts, and how to locate local resources are the SBA's other top programmatic priorities (*See*, http://www.sba.gov/, last visited on April 10, 2013).

provide the safe, reliable and affordable power. We are particularly concerned that changes of the type being discussed by policymakers today will hurt our members' ability to obtain financing, increase the cost of such financing, and, ultimately, increase the price that public power customers pay for electricity, especially affecting small businesses and low- and fixed-income households.

Municipal Bonds

Municipal bonds have been used for centuries by state and local governments to finance a wide range of public infrastructure. They allow state and local governments to build projects with capital provided upfront by bond investors, repaid over the projects' useful life by the citizens and customers benefitting from the project.

Municipal bonds are the largest source of financing for core infrastructure in the U.S.,[3] and are the single most important financing tool for public power, given the capital-intensive and long-lived nature of assets needed by the electric industry. Each year, on average, public power utilities make $15 billion in new investments financed with municipal bonds. Over the last 10 years, new money issuances for power-related projects have totaled more than $150 billion, roughly 9% of all municipal bond issuances.[4]

Public power utilities use municipal bonds to finance investments in power generation (including through renewable and alternative fuels), transmission, distribution, reliability, demand control, efficiency, and emissions controls. While the typical power-related bond issue is larger than the typical municipal bond generally, it is still dwarfed in size by the average corporate taxable bond issue.[5]

Because interest on municipal bonds is exempt from federal income tax, investors generally accept a lower rate of return than they would otherwise demand from issuers of taxable debt. In contrast to Investors are also attracted to municipal bonds because of the stability of the municipal bond market and the extremely low rate of default for municipal bonds. Historically, interest rates demanded by investors for tax-exempt municipal bonds have been an estimated average 200 basis points lower than comparable taxable corporate bonds. Savings to the issuer from this reduced cost in borrowing allow further investments or are passed through to taxpayers in the form of lower taxes or, in the case of public power customers, reduced utility rates.[6]

An added advantage of municipal bonds as a source of state and local financing is that the need for, and terms of, financing are determined by state and local citizens, either directly or through their representatives. Additionally, significant flexibility is afforded to state and local government issuers compared to issuers of taxable debt, including the term of the issue, the debt structure, and the ability to optionally call fixed rate debt after 10 years.

Current Financing Alternatives

Several alternative debt instruments exist that supplement tax-exempt municipal bonds as a means of financing state and local infrastructure investments. However, as explained below, each has its own

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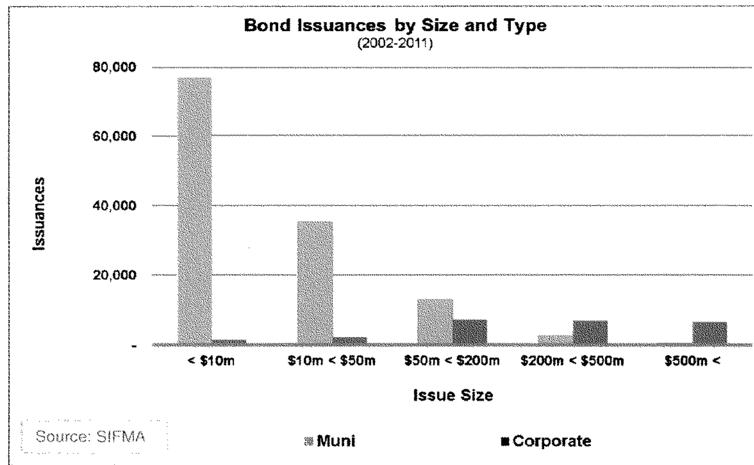
[3] Cong. Budget Office, J. Comm. on Taxation "Subsidizing Infrastructure Investment with Tax-Preferred Bonds" (Oct. 2009)(showing that for education, water, and sewer, nearly all capital investments are made by state and local governments and that for transportation most investments are made by state and local governments).
[4] The Bond Buyer & Thomson Reuters "2012 Yearbook" (2012); The Bond Buyer & Thomson Reuters "2007 Yearbook" (2007).
[5] *Ibid.* (for years 2002-2011, the average municipal bond issuance was $30 million; the average power-related municipal bond issuance was $83 million; and, the average corporate bond issuance was $371 million)(data on corporate bond issuances provided by the Securities Industry and Financial Markets Association).
[6] American Public Power Association "2012-2013 Public Power Annual Directory and Statistical Report" 51 (2012).

inefficiencies and none, alone, would be a viable replacement for municipal bonds.

Taxable Bonds

On occasion, state and local governments issue taxable debt to finance infrastructure investments, generally as a supplement to financing provided by tax-exempt debt. Taxable bonds appeal to a different type of investor, typically those less concerned with tax considerations (such as pension funds and foreign investors) and so can expand the potential pool of investors for a larger project. Because investors generally demand a higher rate of return on taxable bonds than on tax-exempt municipal bonds, there use is limited and could not replace tax-exempt municipal bonds as a means of financing.

Other considerations also limit the use of taxable bonds by municipal issuers. Issuers are subject to more restrictions on the terms of debt issued in the taxable market. For example, while the right to optionally call a bond early at par is included in most municipal bonds, such provisions are rare (and costly to include) in taxable bonds. As a result, state and local government issuers are generally effectively precluded from refinancing taxable debt to take advantage of an interest rate decrease.



Direct Payment Bonds

Direct payment bonds are bonds the interest on which is taxable to the bond holder, but for which state and local government issuers receive a direct federal payment generally set at a percentage of the interest rate paid to bond holders. Build America Bonds (BABs) were able to be issued as direct payment bonds from February 17, 2009, through December 31, 2010. The reimbursement rate for these bonds was set at 35 percent. Of the $843 billion in municipal bonds issued in 2009 and 2010, roughly $181 billion were direct payments BABs. This unprecedented willingness of municipal issuers to issue taxable debt stemmed in large part because of the reimbursement rate though also in part because of the unusual difficulties being experienced in the municipal market which the expanded pool of investors provided by issuing taxable debt helped overcome.

The Clean Renewable Energy Bond (CREB) program was intended to provide for not-for-profit issuers the same incentives to invest in renewable projects as was provided by the production tax credit. The original program was a tax credit bond program, but after very limited success, in a new version of the CREB program, New CREBs, was created in 2008 and modified in 2010 to allow issuers the option of receiving a direct payment from Treasury in lieu of providing bond holders a tax credit.

Although direct pay bonds appear to be an efficient means of providing a federal subsidy to issuers of state and local bonds, these bonds have their own inefficiencies. First, concerns about offsetting payments by amounts potentially owed to the federal government under other programs have concerned many issuers. Second, sequestration of direct payment bond payments[7] has confirmed concerns that the federal government could change the amount of the subsidy after issuers borrowed in reliance on the expectation of direct subsidy payments.

Tax Credit Bonds

Tax credit bonds are taxable obligations in which the investor receives a tax credit in lieu of tax- exempt interest. BABs, Clean Renewable Energy Bonds (CREBs), and Qualified Energy Conservation Bonds can be issued as tax credit bonds. They are sophisticated debt instruments that have traditionally been purchased by investment banks for their own account.

The tax credit rate is set daily by the Treasury Department based on the average "AA" corporate rated debt. This "one-size-fits-all" coupon approach has led to either discounting of the bond upon issuance or a requirement that issuers pay a "supplemental coupon" to increase the yield on the bonds in order to attract investors.

In 2008, tax credit bonds were modified to allow investors to separate (or "strip") the tax credits from the bond and sell them separately. However, because the logistics of stripping is complex, investors discount the value of both the credits and the remaining bond. Investors further discount the value of tax credit bonds to reflect additional costs and risks, including the risk that the investor may not have a federal tax liability in later years against which to use the credits.

Because of these difficulties, the demand for tax credit bonds has been limited and issuers have been reluctant to rely on them.[8]

Private Activity Bonds

Private activity bonds issued by state and local governments for certain permitted facilities are exempt from regular federal income tax, but subject to the alternative minimum tax. Such facilities include airports, docks and wharfs, multi-family housing and solid waste disposal facilities, and facilities for the furnishing of local power.

Unlike governmental bonds, these qualified private activity bonds are subject to a wide range of restrictions and limitations including limits on the amount of bond proceeds which may be applied to finance costs of issuance, limits on state bond volume, rules regarding public notice of the bond issue and

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[7] Office of Mgmt. & Budget, Exec. Office of the President, OMB Report to the Congress on the Joint Committee Sequestration for Fiscal Year 2013 48 (Mar. 1, 2013).
[8] Of 29,315 municipal bonds reported to the IRS in 2010, just 199 were tax credit bonds (http://www.irs.gov/file_source/pub/irs-soi/10bd11arra.xls)(last visited Mar. 29, 2013).

the purpose to be financed, and limits on the maturity of the bonds.

Additional restrictions mean private activity bonds are seldom issued by government-owned utilities to finance energy infrastructure improvements such as generation, transmission and distribution assets. Options to remove or alleviate these restrictions to make private activity bonds a better tool for financing power-related infrastructure are discussed below.

Municipal Bond Market

While the use of municipal bonds in America predates the birth of our nation, the first recorded general obligation municipal bond was not issued until 1812. Since then, the municipal bond market has been a steady source of financing for state and local governments. Today, there are nearly $3.7 trillion municipal bonds outstanding, with approximately $400 billion in issuances every year.

The policy of "reciprocal immunity"—that the federal government does not tax interest on state and local borrowing and state and local governments do not tax federal borrowing—and the longevity of this exemption have given municipal bond investors and issuers great confidence in its permanency and allowed the market to function efficiently.[9] While subsequent changes to the tax code have placed additional requirements and restrictions on the issuance of municipal bonds, interest on government-purpose bonds has always been exempt from federal tax.

This stability has allowed the market to accommodate a vast number of issuers. Over 47,000 state and local governments issue debt in this market. By comparison, roughly 5,000 corporations issue debt in the taxable market. The market also accommodates issues that vary significantly in size and rating. From 2002 to 2011, the median municipal issuance was $7 million.

Investors purchase municipal bonds in part because of tax considerations, accepting a lower rate of return because the interest is exempt from federal income tax. But municipal bonds are also valued for their stability, the low rate of risk of default, and their ability to generate a steady stream of revenue for fixed-income households. In 2010, nearly 60 percent of bond interest paid to individuals was reported on returns for households aged 65 and older.

Also, while municipal bonds are perceived by some as an investment of the rich, 52 percent of all bond interest paid to individuals went to households with income of less than $250,000;[10] roughly 75 percent went to households with income of less than $1 million.[11] IRS data also show that for those who own municipal bonds, the amount of interest earned actually declines as a percentage of overall income as income increases. In other words, for households holding municipal bonds, the interest paid is more important as a source of income as household income decreases.

Market and Regulatory Safeguards

There is a longstanding and comprehensive federal legislative and regulatory system in place to regulate the tax-exempt bond market. Both the IRS and SEC have active enforcement programs for state and local bonds to help ensure that the applicable rules are satisfied. Federal tax laws significantly limit: the entities

[9] Conversely, the threat that Congress might alter this tax treatment caused demonstrable harm to the municipal bond market in 2012, both in terms of higher rates for new borrowings and in the loss of value of tax-exempt holdings in the secondary market (*see*, Janney Capital Markets, "Municipal Bond Market Note: The Threat to Tax Exemption" 3 (Oct. 19, 2012)).
[10] Internal Revenue Service, "Statistics of Income—2010: Individual Income Tax Returns" (2012).
[11] *Ibid.*

that can issue tax-exempt bonds; the purposes for which the bonds may be issued; and the investment of bond proceeds. These rules are particularly restrictive for public power utilities. For example, in the case of public power bond issuances, regardless of the size of the borrowing, no more than $15 million (or 10% of the total, if less than $15 million) of the proceeds can go to the benefit of private use. Furthermore, the IRS "private use rules" effectively prevent issuers from using tax-exempt bonds to build larger facilities than are required to meet the needs of their communities or to issue bonds with longer terms than needed.

The SEC and Municipal Securities Rulemaking Board regulate the manner in which state and local governments may sell their bonds and provide rules on the types of disclosure required in connection with the sale of municipal bonds, as well as ongoing annual and material event disclosure.

Significant market-based safeguards also prevent state and local issuers from irresponsibly issuing bonds or using bond financing for ill-advised projects.

Alternatives to the Current-Law Exclusion for Municipal Bond Interest

As Congress considers proposals to reform the federal income tax, it should bear in mind the unique origin of the exclusion for municipal bond interest and the substantial damage that would be done by any of the alternatives currently being advanced. Such proposals would not only affect current bondholders, but would force tax and rate increases on state and local residents to accommodate higher borrowing costs and reduce the amount spent on needed infrastructure by state and local governments.[12]

Some critics say the exclusion for municipal bond interest is inefficient. These arguments come from several sources, including the Joint Committee on Taxation (JCT). However, research over the last decade has called into questioned JCT's conclusions[13] and its methodologies.[14] On the whole, these analyses indicate that inefficiency and revenue lost from the exclusion is dramatically overstated. Even critics of the exclusions agree that at least 80% of the benefit of the exclusion goes to reduce state and local borrowing costs and not as a windfall to investors.[15]

More importantly, there is virtually no disagreement as to who will pay the price if Congress were to upend the 100-year precedent of exclusion to tax municipal bond interest with, for example, a surtax on municipal bond interest.[16] It will not be borne by the investor, who will be compensated with higher rates

[12] Testimony at this hearing indicated that there is consensus among economists that repealing the exclusion would reduce borrowing costs, but cited a single study on the effect of the exclusion for state and local sales taxes and not the exclusion for municipal bond interest (Scott Hodge, Tax Foundation "Testimony on Tax Reform and Tax Provisions Affecting State and Local Governments before the House Committee on Ways and Means" n.1 (Mar. 19, 2013)).

[13] Francis Longstaff, "Municipal Debt and Marginal Tax Rates: Is There a Premium in Asset Prices?" *NBER Working Paper 14687* 21-22 (Jan. 2009); Andrew Ang, Vineer Bhansali, & Yuhang Xing, "Taxes on Tax-Exempt Bonds" *Journal of Finance*, pp 565-601 (Nov. 11, 2008).

[14] James M. Poterba & Arturo Ramirez Verdugo, "Portfolio Substitution and the Revenue Cost of Exempting State and Local Government Interest Payments from Federal Income Tax" *NBER Working Paper 14439* (Oct. 2008); George Friedlander, Citi, "The Tax Exemption of Municipal Bonds: A Much More Efficient Financing Mechanism Than Government Analyses Suggest" (Jan. 17, 2013).

[15] Frank Sammartino, Congressional Budget Office, Testimony before the U.S. Senate Finance Committee Hearing on "Federal Support for State and Local Governments through the Tax Code" (Apr. 25, 2012).

[16] George Friedlander, Citi "Muni Issuers and the Current Market Environment: Threats, Challenges and Opportunities" 10 (Mar. 30, 2012)(estimating a yield increase of as much as 75 basis points); John Hallacy & Tian Xia, Bank of America Merrill Lynch, "Munis & Derivatives Data" 1 (Feb. 13, 2012)(estimating a 40 basis point increase on issuer costs); BLX at 6 (estimating a 77 basis point increase in all-inclusive borrowing costs for large issuers and a 92 basis point increase in all-inclusive borrowing cost for smaller issuers).

for any taxes they pay, but rather by state and local residents forced to pay billions more every year in additional financing costs.

As noted above, throwing roughly 50,000 state and local issuers into the taxable bond market would be incredibly disruptive and costly. Each of the proposed alternatives to tax-exempt bonds comes with its own inefficiencies from the perspective of issuers of these bonds. In contrast, the current municipal bond market provides issuers ready access to capital with maximum flexibility. This market charges a premium to issuers who have undertaken unwise projects or borrowed beyond their constituents' willingness (or ability) to repay these bonds. As a result, it should come as no surprise that municipal bonds are second only to Treasury bonds in their stability.[17]

Repeal

An outright repeal of the exclusion for municipal bond interest would both undermine a century of tax-policy precedent and devastate the ability of state and local governments of all sizes to seek financing in an effective, well-regulated, well-understood, and stable market.[18] Estimates of the increased cost to issue taxable debt vary and generally are based on the historic spread between corporate taxable debt and municipal tax-exempt debt that, on average, has been nearly 200 basis points. Recent analysis of the cost of issuing taxable debt in the current market (with historically-low interest rates) showed a nearly 150 basis point increase for a larger municipal issuer and a 166 basis point increase for a smaller issuer.[19] At the historic spreads, if proposals to eliminate tax-exempt financing had been in place over the last 10 years, it would have cost state and local governments $495 billion in additional interest expense.

The actual costs would likely be far greater, as roughly 50,000 state and local issuers with median financing needs of $7 million would be forced into a taxable market where the median issue for roughly 5,000 corporate issuers is closer to $200 million. While some larger issuers could survive in this market, smaller issuers including small public power utilities could not. As this committee knows, finding financing for any small business is problematic: finding a bank willing to finance a 30-year loan for a power distribution upgrade could or to install scrubbers to add new life to an existing plant could be impossible or, at least, cost prohibitive.[20]

Likewise, flexibility unique to municipal bonds—such as the ability to ladder bond maturities to match revenues and project life and to call bonds prior to maturity to take advantage of changes in interest rates—would be lost or would come at a premium in the taxable market.

28% "Cap"

A "cap" on the tax value of the exemption for municipal bond interest is, in principle and in construction, a surtax on municipal bond interest. For example, to "cap" the tax value of municipal bond interest at 28% as proposed by President Obama, a tax of up to 11.6% is imposed on municipal bond interest. While theoretically targeted at upper-income investors, the reality is that such a tax

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[17] See, for example, Moody's "U.S. Municipal Bond Defaults and Recoveries: 1970-2011" (Mar. 7, 2011)(showing that of a sample of 17,700 rated issuers, just 71 had defaulted over the 42-year period and, of those, just two were public power issuers).
[18] This statement is primarily concerned with the tax policy considerations of tax reform, but a number of academics have questioned whether federal tax on state and local financing would violate constitutional intent and whether the courts would uphold such a tax.
[19] BLX Group LLC, "Tax Reform Proposal Analysis: Impact on Tax-Exempt Bond Financing," prepared for American Public Power Association 6 (Jan. 28, 2013).
[20] Robert Doty, "Threats to Tax Exemption Also Threaten Our Clean Water" Bond Buyer 8 (April 4, 2013).

would hurt the issuers of new tax-exempt bonds and the secondary market value of holdings for all outstanding bond-holders.[21]

As a result, all potential investors would demand an interest rate premium on new issuances either as compensation for the loss of net earnings or to reflect the downward pressure on secondary market value caused by the new tax. An additional risk premium would be demanded to compensate for possible future tax rate increases. Recent analysis shows that a 28% "cap" would increase financing costs for a larger issuer by 77 basis points, while a smaller issuer's costs would increase by 92 basis points.

In addition to increasing the cost of borrowing for state and local government issuers, the notion that the bonds are a "hybrid investment" - that is, depending on the tax status of the purchaser either all or some of the interest will be excluded from federal gross income - adds complexity to all debt issuances, requires more lengthy and comprehensive disclosure and increases borrowing and transaction costs.

Flat-Dollar Cap

A flat dollar cap on the amount of deductions and exclusions a taxpayer could claim would essentially amount to a repeal of the current exclusion for municipal bond interest. Under this proposal, taxpayers would be given the option to exclude from income some or all of such interest if other deductions and exclusions are not used to "fill" the cap. It is generally assumed that taxpayers would first fill the cap with non-optional expenses – such as employer-provided health care, retirement investments, education, child and dependent care, and home mortgage interest. As a result, at the dollar levels being discussed, a flat dollar cap would result in the full taxation of municipal bond interest for most if not all municipal bond holders. The cost in the secondary market to bond holders and to issuers for new issuances would likely be on par with that of a full repeal.

Replacing Municipal Bonds with Tax Credit Bonds

Generally, the tax credit bond market is an illiquid, small market that and could not replace the current municipal bond market. The tax credit bond market cannot absorb the average annual debt issuance of tax-exempt bonds, which over the last 10 years has averaged approximately $380 billion per year.

Purchasers of taxable bonds include entities that pay no federal income tax, such as public pension funds, private pension funds and foreign investors. To attract such investors, the tax credits would need to be stripped and sold to entities that pay federal income taxes. In addition to discounting the amounts paid for credits due to the complexity of stripping and selling a stream of tax credits, purchasers will discount the credits to offset the following: (i) transaction costs; (ii) tax risk associated with concerns that the credits might stop in the event the bonds do not meet the federal bond tax rules; (iii) risk that the investor may not have a federal tax liability in later years to fully utilize the credits; and (iv) default risk and related factors.

Replacing Municipal Bonds with Taxable Direct Payment Bonds

All the concerns regarding cost, access to capital, and flexibility for issuers caused by an outright repeal of the exclusion for municipal bond interest would apply to a replacement of the exclusion with a taxable

[21] ETF Trends "Muni Bond ETFs Tumble on Tax-Break Speculation" (Dec. 14, 2013) (http://finance.yahoo.com/news/muni-bond-etfs-tumble-tax-181300222.html)(last visited Mar. 28, 2013).

direct payment bond. Further, the small issuers that dominate the tax-exempt bond market would be disproportionately affected by having to borrow in the taxable market. Recent analyses show that replacing municipal bonds with a 25 percent direct payment bond would still result in a net cost increase to a large issuer of 51 basis points and to a smaller issuer of 58 basis points.[22] Further, there is a legitimate question among our members as to whether these direct payment bonds have been forever tarnished by the impact of sequestration. This sequestration cut was not envisioned by the drafters of BABs; it therefore calls into question whether or not more cuts would be forthcoming at some point in the future.

Improvements to Municipal Bonds

While much of Congress's recent discussion of municipal bonds has focused on how much revenue could be raised by taxing them, this Committee has begun discussing how to improve the rules surrounding municipal bonds. A thoughtful discussion of ways to modernize the tax code would be welcome.

For example, state and local governments may issue qualified private activity bonds, the interest on which is exempt from federal gross income tax. As mentioned above, qualified private activity bonds may be issued to finance a range of capital improvements to be used by private sector entities. Such improvements include airports, docks and wharfs, multi-family housing and solid waste disposal facilities, and the local furnishing of power, among others.

Unlike governmental bonds, qualified private activity bonds are subject to a wide range of restrictions and limitations, many of which apply specifically to power-related bond issuances:

- Qualified furnishing of power may only be to a city and one contiguous county or two contiguous counties;[23]
- Only up to 10 percent of the output of an electric facility may be used for private use;[24] and
- Only up to $15 million per project of private use for power-related projects.[25]

Private activity bond rules are also used to severely limit the ability of municipal utilities to acquire existing privately-owned, power-related assets with government-purpose bonds.[26]

A related issue is the taxation of capital contributions by public power utilities to investor-owned utilities (IOUs) to build facilities (e.g., interconnections and associated facilities, transformers, circuits, etc.) to serve the public power utility's retail demand ("load") are treated as taxable "contributions-in-aid of construction" to the IOU.[27] Because the IOU traditionally requires the municipal utility to "gross up" its contribution, the cost of the investment is effectively increased by as much as 35 percent.

These limitations severely limit the ability of municipal utilities to work cooperatively with investor-owned utilities to finance energy infrastructure improvements such as generation, transmission and

[22] BLX Group LLC, "Tax Reform Proposal Analysis: Impact on Tax-Exempt Bond Financing," prepared for American Public Power Association 6 (Jan. 28, 2013).
[23] 26 USC 142(f).
[24] 26 USC 141(b)(2).
[25] 26 USC 141(b)(4).
[26] 26 USC 141(d).
[27] 26 USC 118(b).

distribution assets. Re-examining these restrictions could increase public-private partnerships in critical infrastructure investments.

Likewise, we endorse the National Governors Association's all-of-the above approach to municipal finance. For example, while direct payments bonds could not replace municipal bonds, in the case of New Clean Renewable Energy Bonds (New CREBs) and Build America Bonds, they have served as a helpful supplement to traditional municipal bond financing.

Problems with New CREBs have been the limited amount of bond volume available; the laborious process for seeking approval to issue these bonds; and the "locking out" of projects by projects for which allocations have been approved, but which have not begun. Congress has also failed to continue its investment in the policy—extending the production tax credit while failing to increase the allocation for New CREBs.

Taxable direct-payment Build America Bonds (BABs) also provided a welcome expansion of potential investors in 2009 and 2010—a time when the appetite for municipal bonds was limited. The recent experience with the cutting of payments to BABs issuers under sequestration has substantially dampened enthusiasm for BABs in the issuer community. As a result, the cost of issuing such bonds going forward would likely be higher as provisions to recall bonds in the wake of similar budget cuts would be included.

However, a taxable direct payment BAB could still make a welcome supplement to traditional municipal bonds. Reimbursement rates for proposal reinstating BABs are much lower than the 35% provided under the original BABs program. Still, if Congress were demonstrate its commitment to the program going forward, a taxable direct payment bond could be a useful supplement to traditional municipal bonds, and could reduce state and local borrowing costs overall.

CONTACT INFORMATION:

American Public Power Association
1875 Connecticut Ave. NW, Suite 1200
Washington, D.C. 20009

Contact:
John Godfrey
jgodfrey@publicpower.org
(202) 467-2929

Hearing before the Full Committee
House Small Business Committee
April 10, 2013

STATEMENT OF JACK FITZGERALD
FOUNDER
AMERICANS STANDING FOR SIMPLIFICATION OF THE ESTATE TAX (ASSET)

CHIEF EXECUTIVE OFFICER, FITZGERALD AUTO MALLS (MD, PA, FL)

Chairman Graves, Ranking Member Velazquez, and members of the Committee, thank you for the opportunity to provide this testimony on behalf of Americans Standing for Simplification of the Estate Tax (ASSET) regarding the need to reform taxes for America's job creators, beginning with the estate tax. I am very pleased that you have chosen to hold a hearing on ideas for simplifying the tax code and there is a need to address the estate tax and its impact on small businesses, which our organization has advocated for in conversations with a number of members of the Committee and staff.

ASSET was formally organized 2010 in order to bring together the private businesses, family farms and individuals who have been advocating for a change to the collection method for the estate tax. Members of ASSET believe that so long as the IRS requires the estate tax be paid, there is a simpler collection method that allows the same cash flow to the U.S. Treasury, yet doesn't cause jobs losses or the closure of businesses.

I am sure that witnesses will help the Committee understand more fully the potentially devastating impact of the estate tax on small business owners and their employees even today. As Congress begins the process of comprehensive tax reform it should undertake an overhaul of the estate tax. I am hopeful that you will consider our idea for ending the existing estate tax through a change in collection methodology that is initially revenue neutral, reduces compliance costs substantially, frees up capital, and does no harm to the Treasury or the taxpayer.

I believe that our proposal, the ASSET plan, will manage to generate comparable revenues for the U.S. Treasury without the very destructive collection method of the current estate tax. Over the past 50 years, the estate tax has brought in an average of 1.1 percent of total IRS collections, but we are convinced that the current method of collecting this tax is extraordinarily inefficient and distortive. It may come as a surprise to some that the amount that this tax brings in represents only 1.86% of the Adjusted Gross Income (AGI) of the top 1 percent of taxpayers, which reflects the ability of some Americans to avoid paying altogether.

The Case for Reform of the Estate Tax

For many years, I have been concerned by the estate tax. Over the years I have accumulated a collection of small businesses, some with 10 employees or fewer, and some with more than 500. I am in my 70's and now have 1200 very dedicated employees in my car stores whose livelihoods keep me up at night. Under current law, it is clear that upon my death, the

estate tax liability would be so large that my heirs would have no choice but to sell off the company I have spent 47 years building, likely selling the real estate and effectively dismantling the operations. To prevent this, I have purchased substantial amounts of life insurance – annual premiums as high as $684,000 in after tax dollars – so that my employees will still have jobs and the company can continue without such severe dislocation.

I am hopeful that the Committee would agree that the current version of the estate tax is counterproductive and is really in many cases a tax on the jobs of employees at productive, living businesses. For privately held businesses, if there is insufficient life insurance on the owner, a thriving company usually must be sold or broken up – a dead loss for the economy because of the dislocation that occurs. Or, the business is sold off early, prior to the death of the owner, which often leads to consolidation and job losses. It's not just lower income employees who are hurt; many of the jobs lost in these preventive sales are higher paying white collar jobs.

The case for reform is dramatically illustrated by reviewing the data cited by the Congressional Joint Economic Committee in its May 2006 and July, 2012 study, which indicated that individuals' costs of complying with the estate tax (avoiding wealth transfer taxes) roughly equals the revenue yield of the estate tax for the Treasury.

The JEC study accurately states that according to the CBO, approximately 5 percent of all estates that owed estate taxes in 2000 (the latest data available) had a tax liability that exceeded their liquid assets (i.e. bonds, corporate stock, bank accounts, and insurance); for estates of farmers, the figure was 8 percent, and for family owned businesses, the figure was even greater, at more than a third. Farm assets and business assets represent 17.1 percent of the gross taxable estate value as of 2009, the third largest category following stock (30percent) and real estate (22 percent).

The estate tax as we know it is an arbitrary and inefficient way to impose such costs, and its distortive effects call out for a simpler, more equitable approach. Lost in the debate at the 13th hour at the end of 2012 over rates (35% vs. 40%) and exemptions ($1 million, 3.5 million or $5 million) is a more fundamental question – why keep the current broken structure in place when it does such harm?

The proposal that I will outline in this statement reflects more than 150 meetings and conversations that I have had over the past three years. I have spoken with chairmen of Congressional committees and subcommittees, IRS staff, and numerous small business owners, farmers, and ranchers around the nation. ASSET has more than 3,000 supporters and growing. I have also reached out to many thoughtful experts at organizations along the whole political spectrum and ASSET hired a major local economist to help dive even further into the issue.

I am motivated to seek change because of stories such as the one I heard from farmer Teddy Butz from Windbridge Farm and a member of ASSET: "We had an Aunt pass away and now the heirs are being forced to sell part of the farm to cover the Estate Tax. Now is not the time to sell. Had the ASSET program been in effect, this problem could have been averted or reduced."

I believe that the answer lies between the public outcry to "end the death tax" and the calls from others on the political spectrum to impose significant taxes on those who are fortunate enough to die with vast amounts of accumulated wealth. The ASSET proposal would simplify the tax system by replacing the current collection methodology and substituting as an interim measure a pay-as-you-go, revenue neutral alternative collection mechanism that will, over time, vanish thanks to the anticipated windfall of capital gains tax receipts.

Rather than delay consideration of estate tax reform proposals until the after dealing with Corporate tax reform or the next fiscal crisis, Congress and the White House should be spending time now considering policy options such as the ASSET proposal so a full public debate can occur and we don't find ourselves just extending a tax policy because it's the path of least resistance. Today's hearing is an excellent example of a Congressional committee taking steps in the right direction.

Some background on the estate tax is essential to understanding the public policy and economic rationale for the ASSET proposal. Under current law, after an owner's death, or even sometime just before, farms and businesses are often unnecessarily liquidated, causing huge job losses. Private capital is locked up in unproductive trusts to escape tax liability, meaning that many of the best business minds in our nation are forced to sit idly by and can't create new wealth with their assets because they must lock them away for their heirs to inherit. Further, many Americans purchase unnecessarily high amounts of life insurance to anticipate this feared tax.

From 2005-10, the estate tax averaged around 1 percent of total IRS collections, with $16.9 billion collected in 2010. There are two additional statistics that certainly lend credence to the notion that many of the wealthiest Americas are able to game the current system and skate free: (1) only 15,191 estate tax returns were filed in 2010, with less than half (6,711) owing any estate tax; and (2) over the 25 years from 1985-2009, the wealthiest Americans earned nearly $23 trillion in income -- yet the estate tax revenue in the same period was less than 2 percent of that amount, suggesting that tax avoidance is widespread.

Background on the ASSET Proposal

The ASSET proposal attempts to simplify the estate tax by changing the collection mechanism for the same population that is likely to leave an estate. This proposal depends on a temporary "bridge" to maintain revenue neutrality for the first few years and then may succeed in eliminating the need for the bridge mechanism through an increase in revenues from capital gains taxes that should occur. But the harmful effects of the current estate tax collection method cease immediately.

The ASSET proposal would stop imposition of the current estate and gift taxes and would substitute a temporary revenue neutral combination of budgetary offsets that could include: (1) a very small surcharge on individuals whose AGI in a given year exceeds $1 million; and/or a pay for that (2) reduces deductibility of certain tax preferences for individuals whose AGI exceeds $1 million. We are open to suggestions of possible consensus budgetary offsets and would note that any such offsets are intended to be temporary in nature because of the capital gains revenue

windfall described below. In 2011 ASSET commissioned a study by the a prominent think tank economist to examine potential pay fors and the revenue needed.

Because the individuals covered by these proposed budgetary offsets already typically spend as much or more annually on accountants and attorneys in order to minimize or eliminate estate tax liability, we believe that these individuals will actually welcome the opportunity to manage their affairs without having to contend with the current estate and gift taxes.

Based on discussions with the Joint Tax Committee staff and others, we believe that a surcharge option could be below 2 percent, which would mean $20,000 for a covered taxpayer. I can assure you that $20,000 is a minimal cost to someone making $1 million in AGI when he or she considers the thousands of dollars in lawyers' fees and life insurance that person is paying annually to avoid the impact of the current estate tax. The surcharge can be this low because all the loopholes are eliminated and a larger number of taxpayers will be paying into the system (however, only in years where their AGI exceeds $1 million).

The ASSET proposal clearly would eliminate the need for sheltering assets in unproductive trusts whose sole rationale is avoiding the estate tax. Our proposal would also eliminate the need to over-purchase life insurance – a diversion of productive resources away from investment and job creation and into less productive uses.

An exciting element of the ASSET proposal is that it will include legislative language phasing out the budgetary offsets over time if, as we believe, there will be a capital gains tax windfall for the Treasury as a result of the unlocking of the billions of dollars of assets held in trusts. The IRS has informed us that it could track specific assets, at carryover, and thus keep track of whether the enhanced capital gains tax receipts caused by estate tax reform are sufficiently high to reduce or phase out the surcharge in the out years without violating the revenue neutral principle of this proposal.

Ultimately, in eliminating the need to liquidate businesses because the owner has died, the ASSET proposal preserves thousands of critically needed jobs at American small businesses, farms, ranches, and other business concerns. Plus, the economic activity that will result from the unlocking of the assets in unproductive trusts should help stimulate our economy – without needing an extra dollar from the U.S. Treasury.

We recognize that some in Congress and the Administration are interested in much more comprehensive tax reform. Our proposal is consistent with that effort and could serve to help jumpstart the issue and preserve the jobs provided by small businesses as broader tax policy changes are hashed out.

I encourage Members of Congress and the Administration to analyze this proposal and to give it full and fair consideration. The proposal meets the principles stated by officials and activists on both sides of the spectrum and could be the right solution for this pressing problem.

AMERICAN TRUCKING ASSOCIATIONS
950 N. Glebe Road ★ Suite 210 ★ Arlington, VA ★ 22203-4181
www.trucking.org

Bill Graves
President and Chief Executive Officer

April 8, 2013

The Honorable Sam Graves
Chairman, House Committee on Small Business
United States House of Representatives
Washington, DC 20515

Dear Chairman Graves:

The American Trucking Associations (ATA) thanks you for the opportunity to testify for the record on the pressing issues involving federal tax reform and small business.

ATA is particularly concerned with the problems of small business since most motor carriers are small businesses. The average trucking company operates just six vehicles, an average that has stayed constant for many years. Altogether, there are several hundred thousand interstate carriers that qualify as small businesses. Many of these are organized for tax purposes as pass-through entities. Our industry is therefore vitally interested in the reform of both the individual and the corporate income taxes.

In our view, the primary aims of tax reform are two: First, the achievement of a balance between the reduction in the rates of the personal and corporate taxes on the one hand, and a narrowing of the existing tax breaks, deductions, and the like on the other. We do not underestimate the difficulty involved in arriving at an acceptable balance in this respect. Second, Congress must undertake to simplify the Tax Code in wholesale fashion. In its current state, the federal tax law is not only overwhelmingly complicated for most taxpayers, but its very complexity has become a drag on the American economy. For small businesses, the simplification of the Code may be the more important of the two goals of tax reform.

ATA believes that the Discussion Draft focusing on small business issues that was released last month by the House Ways & Means Committee represents a useful beginning towards the necessary reforms. We applaud the inclusion in the Draft of such items as:

- the simplification of the current process for the election of Subchapter S status;
- the easing of the rules for the conversion of Subchapter C corporations to pass-through entities; and
- relaxing the rules on cash accounting for the smallest businesses.

The revenue implications of changes such as these are limited, yet simplifying amendments to the Code have real effects on the cost – and even the ability – of small businesses to comply with their tax obligations. As reform proceeds, the Code will offer many additional opportunities for changes of this kind.

Good stuff.

703-838-1804 ★ FAX: 703-838-1994 ★ bgraves@trucking.org

The Honorable Sam Graves
April 8, 2013
Page 2

Clearly, the Ways & Means draft on small business represents only a small piece of what must be undertaken if tax reform is to be successful. The overall framework goals and assumptions within which Ways & Means is working is missing from its draft. This lack of context makes it difficult to judge the significance of the specific reforms proposed in it. Moreover, there is little evidence in the draft of the wholesale simplification of the Tax Code that Congress must achieve.

On the broader issues, motor carriers, especially the majority of them that are small businesses, have two particular concerns:

(1) Trucking is dependent on regular investments in expensive items of capital equipment. In reaching an appropriate balance between the reduction of the federal tax rates and the broadening of the tax base, Congress must ensure that small business retains the ability to finance these investments. In the current tax law, the overall system of accelerated depreciation (MACRS), the ability of businesses to deduct interest payments, and the expensing under Section 179 of the Code of a limited amount of capital investments are all important in this regard to various segments of our industry. Elimination of these will have to be offset by very significant reductions in tax rates at both the corporate and personal levels if trucking companies are to continue to be able to finance the purchase of new, cleaner, safer rolling stock or, indeed, to remain in business at all.

(2) By its very nature, interstate trucking is a mobile industry. Even very small motor carriers regularly travel through many of the states. Because of this, trucking companies, particularly small trucking companies, face a serious threat of disproportionate compliance costs related to state business taxation, from states in which these companies do little or no business and with which they have few if any of the connections that are commonly considered to establish tax nexus. ATA has long called for federal relief from overreaching and inequitable state taxation of interstate commerce in this respect. We emphasize that our industry's primary concern in this area is compliance costs rather than the amount of taxes involved. The relief we request should affect aggregate state revenues little if at all. We urge Congress to enact such business tax relief as a part of the overall effort of tax reform.

Once again, ATA appreciates the opportunity to submit these comments to the Committee.

Sincerely,

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

R. BRUCE JOSTEN
EXECUTIVE VICE PRESIDENT
GOVERNMENT AFFAIRS

1615 H STREET, N.W.
WASHINGTON, D.C. 20062-2000
202/463-5310

April 10, 2013

The Honorable Sam Graves
Chairman
Committee on Small Business
United States House of Representatives
Washington, DC 20515

The Honorable Nydia M. Velazquez
Ranking Member
Committee on Small Business
United States House of Representatives
Washington, DC 20515

Dear Chairman Graves and Ranking Member Velazquez:

The U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than three million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations, and dedicated to promoting, protecting, and defending America's free enterprise system, applauds your efforts to continue discussions on comprehensive tax reform by holding today's hearing, "Small Business Tax Reform: Growth Through Simplicity." The Chamber appreciates the efforts of the Committee on Small Business to work with the Committee on Ways and Means on issues related to comprehensive tax reform. This hearing is an important step in that process.

As you consider pro-growth policies that should be part of tax reform, the Chamber believes tax reform should adhere to certain principles. Tax reform should:

- Be comprehensive, lowering rates on both the individual and corporate sides of the code;
- Eliminate the bias against capital investment and contain proper cost recovery rules;
- Shift to a territorial system of taxation so that American worldwide companies can domestically expand and compete globally;
- Make changes to the code permanent so to eliminate the uncertainty that suffocates businesses' ability to purchase, hire, and expand;
- Include simple, predictable, and easy to understand tax rules to ease compliance burdens;
- Give equal attention to government spending to strike a reasonable balance with a tax code that fosters economic growth, job creation, and investment;
- Ensure industry-specific neutrality and avoid special tax benefits or penalties targeted to one industry versus another; and
- Include appropriate transition rules to allow time for implementation.

The Chamber has delivered a detailed submission to the Tax Reform Working Groups, attached here, that provides additional information on these items.

The Chamber appreciates the ongoing efforts of Congress to work towards comprehensive tax reform. We look forward to our continuing work with you in this process.

Sincerely,

R. Bruce Josten

Statement of the U.S. Chamber of Commerce

ON: ***Statement on Tax Reform Principles and Priorities***

TO: ***Tax Reform Working Groups***

DATE: ***April 2, 2013***

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

INTRODUCTION

Chairman Camp, Ranking Member Levin, Members of the Committee, and tax working group members, the U.S. Chamber of Commerce greatly appreciates the opportunity to comment on how we can reform the tax code.[1]

The Chamber appreciates the commitment of the Committee and the working groups to comprehensive tax reform. We applaud the Committee and Chairman Camp for engaging stakeholders through such an open and transparent process. We also understand the challenges presented by this kind of reform but urge the Committee to continue its work to reform the code as soon as possible. Further, as Congress works towards that goal, we strongly urge, that in the interim, no adverse changes should be made to current tax policy.

REVENUE AND SCORING ISSUES

As a cursory matter, the Chamber believes that taxes should be levied for the purpose of obtaining those revenues necessary to fund limited government expenditures in a way that minimizes the negative impact on taxpayers, overall economic growth, and the international competitiveness of American business. Further, Congress should give equal attention to government spending to strike a reasonable balance with a tax code that fosters economic growth, job creation, and investment.

Discussions of tax reform frequently focus on "tax expenditures" contained in the Code. The Chamber believes that these tax expenditures are impossible to define, measure, or aggregate accurately. Revenue estimates of tax expenditures have become such an integral part of the tax policymaking process, however, that how they are conducted is of paramount importance. Thus, as Congress considers comprehensive tax reform, the Chamber urges revenue estimators to take into account likely changes in taxpayer behavior rather than assuming that taxpayers will not take changes in the tax law into consideration.

A recent study[2] by the nonpartisan Tax Foundation highlights the need for such "dynamic" revenue scoring. While noting that static scoring has "the advantage of simplicity, and it is not too far from the truth for tax changes that either have little impact on incentives at the margin or affect parameters that do not respond much to incentives," they note that this is an "extremely unrealistic assumption," particularly in the case of the corporate income tax rate. They further note that:

> [c]hanges in that rate do alter rewards at the margin and investors respond strongly to incentives. In other words, when the full economic effects of cutting the corporate

[1] All references to the code are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

[2] See Schuyler, Tax Foundation, "Growth Dividend from a Lower Corporate Tax Rate," *available at* http://taxfoundation.org/article/growth-dividend-lower-corporate-tax-rate. Note that a majority of the Senate endorsed "dynamic scoring" of changes in tax law during the budget process in 2013. See "The Senate Gets Dynamic," *Wall Street Journal* (April 1, 2013), *available at* http://online.wsj.com/article/SB10001424127887324685104578386280984564380.html?mod=ITP_opinion_2.

income tax rate are taken into account, the federal treasury would collect more in total revenue than it would lose from the lower rate.

The Chamber agrees that behavioral changes should be considered as comprehensive tax reform is explored and strongly urges Congress to consider the dynamic impacts of tax policies.

COMPREHENSIVE TAX REFORM

The Chamber believes that Congress should undertake comprehensive tax reform – both the individual and corporate tax codes should be reformed simultaneously. The individual and corporate codes are intertwined in such a manner that they must be reformed at the same time.

For example, business tax expenditures included in the code apply to both corporations and pass-through businesses (non-corporate firms such as sole proprietors, S-corporations, limited liability corporations, and partnerships). If corporate tax reform were to take place separately from individual tax reform, and the corporate rate were lowered in exchange for the elimination or reduction of business tax expenditures, pass-through entities would lose the benefit of business tax expenditures without a corresponding rate reduction, thereby harming those businesses.

Likewise, there are many additional interactions between the individual and corporate codes, such as the double taxation of dividends. As such, the Chamber believes that reform must look at both parts of the code simultaneously to ensure consistency across the code and overall pro-growth tax policies.

Additionally, the interrelationship of large businesses, often operating under the C corporation portion of the code, and small businesses, often organized as pass-through entities, is undeniable. According to a September 2010 study,[3] the supplier-buyer relationship between American small businesses and large American companies is a basic and entrenched aspect of our economy. Large companies are major customers of small businesses and play a critical role in their growth and success. This once again drives home why we must reform both the individual and corporate codes at the same time.

MARGINAL RATE REDUCTION

Low tax rates promote capital formation and economic growth. Thus, the Chamber believes that tax reform should lower the marginal tax rates to a level that will enable U.S. businesses to compete successfully in the global economy, attract foreign investment to the United States, increase capital for investment, and drive job creation in the United States.

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[3] See "Mutual Benefits, Shared Growth: Small and Large Companies Working Together," *available at* http://businessroundtable.org/uploads/studies-reports/downloads/Small_Big_Business_Report_FINAL.pdf. The study concluded that, "[p]arent operations of U.S. multinational companies buy nearly a quarter of all the goods and services they use as inputs in their production from U.S. small businesses – more than an estimated $1.5 trillion annually; and [e]very $1 billion in new exports by large U.S. companies would result in approximately $174 million in new purchases of goods and services from America's small businesses."

Corporate Rate Reduction

High Rates and Inaction

Currently, the United States has the highest marginal corporate tax rate among Organisation for Economic Cooperation and Development ("OECD") countries.[4] At 35%, the U.S. marginal corporate tax rate is completely out of step with other major industrialized OECD nations. As noted by the Tax Foundation, "studies show that even the *effective* corporate tax rate in the United States is one of the highest in the world."[5] Last year, they noted that "2012 mark[ed] the 21st year in which the U.S. corporate tax rate has been above the simple average of OECD nations. Even if we account for country sizes, the weighted average of OECD nations fell below the U.S. rate in 1998 and has been getting lower ever since."[6]

We not only shackle our businesses with high rates, but we have taken no action to lower our rate as other countries have acted. As the Tax Foundation notes, "there have been 133 major corporate tax cuts globally since 2006. Indeed, between 2006 and 2010 alone, more than 75 countries cut their corporate tax rates - some more than once." Our major trading partners– Canada and the United Kingdom – have already taken steps to make themselves more competitive by dropping their corporate tax rates, while the United States has done nothing to reduce rates.[7] Tax reform must address the U.S.'s uncompetitive marginal corporate tax rate.

For example, in Canada, the business tax rate was reduced to 15% on January 1, 2012.[8] This tax cut was the most recent in a series, first initiated in 2006, that lowered Canada's federal corporate income-tax rate to less than half of the U.S.'s 35%. This rate cut has resulted in little loss in corporate revenues (when compared with pre-recession revenue levels).[9] Likewise,

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[4] See Hodge, "The Countdown is Over. We're #1," Tax Foundation, *available at* http://taxfoundation.org/article/countdown-over-were-1. The United States just recently passed the year mark of holding the number one position. See Becker, "Corporations: America's had top corporate tax rate for one year," *TheHill.com* (April 2, 2013), *available at* http://thehill.com/blogs/on-the-money/domestic-taxes/291157-corporations-americas-had-top-corporate-tax-rate-for-one-year.

[5] See Schuyler, Tax Foundation, "Growth Dividend from a Lower Corporate Tax Rate," *available at* http://taxfoundation.org/article/growth-dividend-lower-corporate-tax-rate (emphasis added). They note that across all 13 studies they examined, the U.S. effective corporate tax rate exceeded the foreign average by 7.6 percentage points, if all countries are counted equally. Further, they note that the U.S. effective corporate tax rate "exceeded the foreign average by 3.7 percentage points, if countries are weighted by their gross domestic products (GDP)." Id.

[6] See Hodge, "The Countdown is Over. We're #1," Tax Foundation, *available at* http://taxfoundation.org/article/countdown-over-were-1.

[7] See id.

[8] See Hodge, "Canada Cuts Corporate Tax Rate to 15%, Lowest Overall Rate in G-7," Tax Foundation, *available at* http://taxfoundation.org/blog/canada-cuts-corporate-tax-rate-15-lowest-overall-rate-g-7.

[9] See id. Hodge, quoting an article in the *Globe and Mail*, that,

> Remarkably, the gradual lowering of the corporate tax rate appears to have resulted in little loss in corporate tax revenue (when compared with long-term, prerecession revenues). Corporate tax revenue did take a big hit ($10-billion) in 2008, the year of the market meltdown. But the tax cuts were barely started in 2008. By 2010-2011, federal corporate tax revenue reached $30-billion, substantially more than the average of $25-billion in the last four years of the prior Liberal government: 2002 through 2005. Further, federal corporate tax revenue equalled (sic) 1.8 per cent of Canadian gross domestic product, a much higher percentage than the revenue produced during the recessionary years in the early 1990s. In tough-times 1992, for example, corporate revenue, with higher tax rates, fell to 1 per cent of GDP.

countries like Japan,[10] which was the only country with a higher corporate tax rate than the United States prior to 2012, and the United Kingdom,[11] have also dropped their corporate tax rates.

Foreign Direct Investment (FDI)

Foreign direct investment in the United States is an important part of our economy. According to a March 2013 Organization for International Investment (OFII) report, in 2012, "inbound investment amounted to 11% of all nonresidential domestic investment… and these investments support more than 5 million well-paid insourced jobs."[12] While the United States is currently a leader in the dollar amount of foreign direct investment, its global share has dropped dramatically in recent years, down from 37% in 2000 to 17% in 2011.[13] The U.S.'s high corporate tax rate not only affects the ability of American worldwide companies to compete, but also is a factor that can impact decisions by foreign companies to invest in the United States.

Estimates of the responsiveness to corporate tax rates on FDI vary, but a 2008 OECD analysis[14] of the literature finds "an average semi-elasticity value of –3.72 (measuring the percentage change in FDI in response to a 1 percentage point change in the tax rate)." In other words, a one percent increase in a tax rate can result in a decrease in FDI of 3.72%.[15] The OECD study further notes that "studies using more recent data are found to produce larger semi-elasticities, indicating that FDI is becoming more responsive to taxation over time."[16]

While greater competition for global investment and emerging markets play a role in global allocation of investment, the tax sensitivity articulated in the OECD report cannot be ignored. If the United States wishes to retain, or increase, its attractiveness to foreign investment, a lower tax rate is a vital aspect of attracting that investment that can drive job and economic growth.

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[10] See Hodge, "The Countdown is Over. We're #1," Tax Foundation, *available at* http://taxfoundation.org/article/countdown-over-were-1.

[11] See "UK announces a further corporate tax rate reduction," Deloitte, European Tax News Alert (Dec. 10, 2013), *available at* http://www.pwc.com/us/en/tax-services-multinationals/newsletters/european-tax-newsalert/uk-announces-further-corporate-tax-rate-reduction.jhtml. Chancellor George Osborne announced in December 2012 a reduction in the main corporate tax rate to 21%, effective April 1, 2014. The U.K. corporate tax rate is already scheduled to decrease to 23% effective April 1, 2013. The United Kingdom "will then have the lowest tax rate of any major western economy." Id. More recently, on March 20, 2013, Chancellor Osborne announced that the United Kingdom will again drop its rate, to 20%, in 2015. See "Osborne says UK corporation tax to fall to 20 percent in 2015," *available at* http://www.reuters.com/article/2013/03/20/us-britain-budget-corporation-idUSBRE92J0LV20130320.

[12] See OFII, "Foreign Direct Investment in the United States 2012 Preliminary Data," (March 2013), *available at* http://ofii.org/docs/FDIUS_3_20_13_FINAL.pdf.

[13] See id.

[14] See OECD, "Tax Policy Study No. 17: Tax Effects on Foreign Direct Investment: Recent Evidence and Policy Analysis," Executive Summary, *available at* http://www1.oecd.org/ctp/tax-policy/39866155.pdf.

[15] See also Hodge, "Ten Reasons the U.S. Should Move to a Territorial System of Taxing Foreign Earnings," Tax Foundation, *available at* http://taxfoundation.org/article/ten-reasons-us-should-move-territorial-system-taxing-foreign-earnings.

[16] See OECD, "Tax Policy Study No. 17: Tax Effects on Foreign Direct Investment: Recent Evidence and Policy Analysis," Executive Summary, *available at* http://www1.oecd.org/ctp/tax-policy/39866155.pdf.

High Tax Rate and Impact on Labor

Not only are there detrimental competitiveness and investment issues with the U.S.'s high corporate tax rate, studies suggest that higher corporate tax rates mean lower wages. A December 2010 study by Kevin Hassett and Aparna Mathur[17] examined 65 countries over 25 years and concluded that a 1 percent increase in corporate tax rates leads to a 0.5-0.6 percent decrease in wage rates. Likewise, a study by Desai, Foley, and Hines[18] reinforces this finding, concluding that the burden of corporate taxation is borne by labor to a significant degree.[19]

Pass-Through Entity Tax Rates

High Rates

As Congress considers lowering the corporate tax rate, it also must address the rate of those businesses that operate as pass-through entities. Like corporations, pass-through entities face nearly the highest rate among industrialized countries on business income. Under the individual code, pass-through entities face a top marginal rate of 39.6%, even higher than the anti-competitive 35% rate faced by C corporations. Their combined marginal rates are close to 45%.[20]

Pass-Through Footprint

The number of businesses facing these high rates is significant. According to the Tax Foundation, between 1980 and 2008, the total number of pass-through businesses nearly tripled, from roughly 10.9 million to 31.8 million, and more business income is taxed under the individual Code from pass-through businesses than is taxed under the traditional corporate code.[21]

Additionally, a 2011 study[22] by Ernst & Young found that more than 90% of businesses in the United States are organized as pass-through entities. That study also found that individual owners of pass-through entities paid 44% of all federal business income taxes between 2004 and 2008 and, moreover, that pass-through businesses employ 54% of the private sector work force

[17] See Hassett and Mathur, "Spatial Tax Competition and Domestic Wages," (December 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2212975&download=yes.
[18] See Desai, Foley, and Hines, "Labor and Capital Shares of the Corporate Tax Burden: International Evidence" (2011).
[19] Even the Tax Policy Center (TPC) now treats 20 percent of the corporate income tax burden as falling on labor. See "How TPC Distributes The Corporate Income Tax," (September 2012), *available at* http://www.taxpolicycenter.org/UploadedPDF/412651-Tax-Model-Corporate-Tax-Incidence.pdf.
[20] See Dave Camp, Chairman, House Ways and Means Committee, Letter to Paul Ryan, Chairman, House Budget Committee, *available at* http://images.politico.com/global/2013/03/10/fy14_budget_letter_from_wm.html (dated 3/6/13). See also House Budget Committee, FY2014 Budget Resolution, *available at* http://budget.house.gov/uploadedfiles/fy14budget.pdf.
[21] See Hodge and Raut, "Individual Tax Rates Also Impact Business Activity Due to High Number of Pass-Throughs," Tax Foundation, *available at* http://taxfoundation.org/article/individual-tax-rates-also-impact-business-activity-due-high-number-pass-throughs#_ftn3.
[22] See Carroll and Prante, "The Flow-Through Business Sector and Tax Reform," *available at* http://www.s-corp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf.

in the United States.[23] The same Ernst & Young report found that if corporate tax reform is undertaken separately from individual tax reform, the income taxes paid by pass-through entity owners would have increased, on average, by 8%, or $27 billion annually between 2010 and 2014.[24]

Entity Choice Considerations

As Congress considers comprehensive tax reform and the appropriate marginal rates for businesses, the Chamber believes it is crucial that consideration be given to why taxpayers choose to operate as pass-through entities.

From a tax perspective, operating as a pass-through entity avoids the double taxation that C corporations face – they are taxed at the corporate level on their profits and many of their shareholders pay tax again when those same earnings are distributed as dividends or when shareholders sell their stock and remit capital gains taxes; conversely, pass-through entities pay no entity level tax and, instead, profits are reported on the individual returns of owners.

From a non-tax perspective, taxpayers choose to operate as pass-through entities for a variety of non-tax reasons. Pass-through entities provide flexibility that the C corporation structure does not allow. For example, partnerships can have one partner put in cash, another put in property, and another expertise. They can then set up their own agreement for how the profits will be divvyed up; a C corporation structure does not have that flexibility.

Simplicity is another non-tax reason taxpayers choose a pass-through entity form. To form a partnership all that is needed is two people with a profit motive and an agreement. Conversely, with a C corporation a taxpayer has to file articles of incorporation, elect a board of directors, have regular shareholder and director meetings, etc. Further, pass-through entities make it easier to plan for business succession and ease estate tax planning concerns.

Progressivity Issues

As Congress considers comprehensive tax reform, the Chamber notes that we already have one of the most progressive tax systems when compared with other OECD countries; our higher income earners and successful small businesses already shoulder more than their fair share of the income tax burden.

Our tax burden is already heavily skewed toward higher income earners. A 2012 Congressional Budget Office (CBO) report[25] shows that in 2009 the top 1% of households paid almost 23% of ALL federal taxes and the top 20% ("highest quintile") paid almost 68% of all taxes. Conversely, the middle and lowest quintile paid only 9.4% and 0.3%, respectively. For the bottom quintile, this represents the lowest shares in the CBO's entire reporting period from 1979 to 2009.

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[23] See id.
[24] See id.
[25] See CBO, "The Distribution of Household Income and Federal Taxes, 2008 and 2009," updated August 10, 2012, *available at* http://cbo.gov/publication/43373.

The imbalance in the tax distribution becomes more pronounced when only income taxes are considered. According to IRS Statistics of Income (SOI) data for 2010,[26] the top 1% of taxpayers, while earning 19% of income, paid 37% of the total income taxes collected by the federal government. Further, the top 5% of taxpayers, while earning 34% of income, paid about 59% of income taxes in 2010. Conversely, the bottom half of taxpayers earned 12% of all income, but paid only 2.36% of all income taxes. Even this understates the true progressivity of the federal income tax system, since it fails to reflect that many taxpayers in the bottom quintile actually face negative income tax liabilities.

In sum, given the significant and growing number of businesses that operate in pass-through form, the reasons for certain entity elections, and the existing progressivity in our system, the rate of tax these businesses are subject to also must be addressed. Further, there is bipartisan recognition of this need for comprehensive tax reform.[27] Accordingly, as Congress considers lowering the tax rate paid by those taxpayers who operate in C corporation structures, it must also address the rates paid by those pass-through entities that remit tax at individual marginal rates.

INTERNATIONAL

It is to the mutual advantage of all countries that the exchange of goods, capital, and services in international trade not be unduly hindered by taxation. Even if other conditions are favorable, excessive taxation by a single country or multiple taxation by two or more countries of the same property or income will destroy the incentives to incur the risks involved in international business.

Pro-growth international tax policies are instrumental to both the ability of American worldwide companies to compete globally and grow not only their global footprint, but also U.S. jobs and operations. Additionally, as noted above, international tax policies must not hinder foreign investment in the United States and the economic and job growth it brings.

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[26] See IRS SOI, "Number of Returns, Shares of AGI and Total Income Tax, AGI Floor on Percentiles in Current and Constant Dollars, and Average Tax Rates; Classified by: Selected Descending Cumulative Percentiles of Returns Based on Income Size Using the Definition of AGI for Each Year, Table 1, Tax Years: 2001–2010."

[27] See "Congress Weighs Small Business Tax Reform," *Accounting Today* (March 4, 2011), *available at* http://www.accountingtoday.com/news/Congress-Weighs-Small-Business-Tax-Reform-57476-1.html?zkPrintable=true (Congressman Tiberi, Chairman, Way and Means Subcommittee on Select Revenue Measures, noting that "[r]eforming corporate taxes means only reforming roughly 10% of federal revenues… That's not comprehensive tax reform. Many small businesses pay taxes under the individual income tax rates, as pass-through entities. The last thing we want to do as a part of tax reform is create a situation where we are putting small businesses at a competitive disadvantage."); Hearing Statement of Senator Max Baucus (D-Mont.) Regarding Changes in the Tax Code since the 1986 Tax Reform Act (March 1, 2011), *available at* http://www.finance.senate.gov/imo/media/doc/03012011%20Baucus%20Hearing%20Statement%20on%20Changes%20in%20the%20Tax%20Code%20since%201986%20Reforms.pdf (Likewise, Senate Finance Committee Chairman Max Baucus has stated, "[w]e receive more revenue from pass-through businesses every year than we do from businesses with traditional corporate structures, called C-corporations. We must consider how efficiently we tax business income, given that so much of it is taxed on an individual basis today.").

Territorial Tax System

The Chamber believes that the U.S.'s current worldwide tax system, developed more than 50 years ago in an age where global competition was less intense,[28] should be replaced with a territorial system for the taxation of foreign source income to help American worldwide companies compete globally and to promote economic growth domestically. A territorial tax system will help allow American worldwide companies to build their global franchises while continuing to strengthen American operations.

In 2013, the United States suffers not only the highest corporate tax rate in the world but is the only major industrialized OECD country that continues to employ a worldwide system of taxation.[29] Our high tax rate and possibility of double taxation, while mitigated by provisions such as deferral and the foreign tax credit, harms the ability of American worldwide companies to compete globally.

In recent years, countries seeking to see their domestic companies succeed in global markets have recognized the myriad benefits of territorial systems of taxation. From increased global competitiveness to decreased lockout impacts,[30] countries have recognized these benefits and reformed their tax codes accordingly. As a result, the remaining number of countries employing worldwide systems of taxation has decreased from 17 in 2000 to only seven in 2010.[31]

For example, consider Japan. Prior to its adoption of a quasi-territorial tax system, it faced issues similar to those of the United States. The Japanese government was concerned about earnings trapped overseas and the inability of Japanese firms to compete globally.[32] Since its international tax reform changes, Japan has seen greater repatriated earnings and its companies holding more globally competitive footing, evidenced through increased acquisitions of foreign companies.[33] Likewise, countries like Germany[34] and the United Kingdom[35] also have adopted territorial systems to confront competitiveness challenges and compliance concerns.[36]

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[28] See Dave Camp, Chairman, House Ways and Means Committee, Letter to Paul Ryan, Chairman, House Budget Committee, *available at* http://images.politico.com/global/2013/03/10/fy14_budget_letter_from_wm.html (dated 3/6/13).

[29] See Dittmer, "A Global Perspective on Territorial Taxation," Tax Foundation, *available at* http://taxfoundation.org/article/global-perspective-territorial-taxation. Chile, Greece, Ireland, Israel, Korea, and Mexico all also employ worldwide but have much smaller economies and lower corporate tax rates.

[30] For a complete discussion of the benefits of territorial tax systems, see Hodge, "Ten Reasons the U.S. Should Move to a Territorial System of Taxing Foreign Earnings," Tax Foundation, *available at* http://taxfoundation.org/article/ten-reasons-us-should-move-territorial-system-taxing-foreign-earnings.

[31] See Dittmer, "A Global Perspective on Territorial Taxation," Tax Foundation, *available at* http://taxfoundation.org/article/global-perspective-territorial-taxation.

[32] See "Japan Disproves Fears of Territorial Taxation," Tax Foundation, *available at* http://taxfoundation.org/article/japan-disproves-fears-territorial-taxation-0. See also Ernst & Young, "International Tax Alert: Japan's move to territorial taxation contrasts with US international tax policy," *available at* http://tax.uk.ey.com/NR/rdonlyres/edb7ggulansyuajnmmscid3lcobk6ap35suar4geem22gu5bvacg3r52522yugcoujqt mppkniq4qf4zw5sz4zuuayd/ITA077.pdf; Testimony of Gary M. Thomas, before House Ways & Mean, May 24, 2011, *available at* http://waysandmeans.house.gov/uploadedfiles/thomastestimony.pdf.

[33] See "Japan Disproves Fears of Territorial Taxation," Tax Foundation, *available at* http://taxfoundation.org/article/japan-disproves-fears-territorial-taxation-0. See also "Lessons in Reform—

While the Chamber urges a shift to a territorial system of taxation, we also believe that the details of a territorial system are of the utmost significance. Proper consideration must be given to issues such as the specific exemption system applicable to foreign dividends, the treatment of other foreign income, exceptions to the exemption regime, the use of foreign tax credits for income that continues to be subject to foreign tax levies, the treatment of expenses, and anti-base erosion provisions. These issues are unquestionably complex but must be addressed if the United States wishes to keep pace in the global economy.[37]

The Chamber notes that should Congress undertake comprehensive tax reform but choose to retain a worldwide system of taxation, provisions that minimize double taxation, such as deferral and foreign tax credits, must be maintained.

Anti-Base Erosion Proposals

Recently, both Chairman Camp's international tax reform proposal[38] and discussions by the OECD[39] have considered the need for and options on anti-base erosion proposals. The Chamber believes it is important to pay great attention to how these proposals would reduce the competitiveness of American worldwide companies and, further, such proposals should in no way punish the success of these companies. If needed at all, proper time and attention should be spent further developing these alternatives and narrowing their impact so as only to affect the activity intended to be discouraged. Further, careful consideration should be given so that anti-base erosion proposals, like tax reform, do not unfairly penalize or impact any one industry or sector.

The Impact of Territorial Tax Systems on Individuals

As with corporations, the United States has long taxed the foreign-earned income of its citizens residing abroad, resulting in double taxation and disincentivizing the hiring of U.S. citizens. Studies have shown that U.S. expatriates employed as managers in foreign affiliates of

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Discussion of Recent Tax Reform in Other Countries," TCPI 11th Annual Tax Policy and Practice Symposium (Statement of Jonathan Stuart-Smith).

[34] See Morrison, "Germany Promotes Competition with Shift to Territorial Tax System," Tax Foundation *available at* http://taxfoundation.org/article/germany-promotes-competition-shift-territorial-tax-system.

[35] See Hodge, "U.K. Strives to have "Most Competitive Tax System Among G20," Tax Foundation, *available at* http://www.taxfoundation.org/blog/show/27157.html.

[36] See Wilson, "Open for business," *The Sun* (5/20/10), *available at* http://www.thesun.co.uk/sol/homepage/news/money/2980284/George-Osborne-Corporation-tax-to-be-lowest-in-G20.html. See also "Lessons in Reform—Discussion of Recent Tax Reform in Other Countries," TCPI 11th Annual Tax Policy and Practice Symposium (Statement of Anneli Collins).

[37] See Chamber Written Testimony, Subcommittee on Select Revenue Measures, House Committee on Ways & Means, Hearing on Ways and Means International Tax Reform Discussion Draft, *available at* http://www.uschamber.com/sites/default/files/111117commentstoWMsonCampint'lPlan.pdf, for additional detail on international tax reform issues.

[38] See Chairman Camp International Tax Reform Proposal, the "Tax Reform Act of 2011," Title III, Subtitle 3, Part 2, *available at* http://waysandmeans.house.gov/uploadedfiles/discussion_draft.pdf.

[39] OECD Newsroom, "OECD urges stronger international co-operation on corporate tax," *available at* http://www.oecd.org/newsroom/oecd-urges-stronger-international-co-operation-on-corporate-tax.htm.

American worldwide companies are a powerful driver of U.S. exports, so this practice significantly undermines the global competitiveness of U.S. exporters. No other country taxes its citizens working abroad, and the any transition to a territorial tax system should take this into consideration and end this damaging practice.

COST RECOVERY

In General

The Chamber believes that another key aspect of tax reform is cost recovery provisions. Tax reform legislation should eliminate the bias in the current U.S. tax system against capital investment. Capital investment should be expensed or recovered using a capital cost recovery system that provides the present value equivalent to expensing with due regard to the impact the system may have on cash flow.

As the Committee and Congress work towards comprehensive tax reform, the Chamber believes that provisions must be included in the code which allow businesses to more quickly recover their capital investments. Failure to include such provisions, even if coupled with a lower marginal rate, is likely to harm economic growth and job creation.

By way of illustration, the United Kingdom is in the process of reforming its corporate tax regime by gradually reducing the main corporate tax rate from 28% to 20% in 2015. The lower rate is being partly paid for with base broadening, in particular, reducing the allowances for capital costs. Capital allowances for plant and machinery have been phased down from 25% to 18%. Capital allowances on industrial buildings have been phased out to zero.

While the U.K.'s tax system has moved in the right direction in terms of the marginal corporate rate[40] and its taxation of foreign source income, a recent study by Oxford University's Centre for Business Taxation[41] assessed the current competitiveness of the new U.K. corporate tax system relative to other G-20 countries and OECD countries. Noting that the intent of the United Kingdom in reforming its corporate tax system was "to create the most competitive corporate tax regime in the G20, while protecting manufacturing industries," the study used a methodology developed in the academic literature which considers the effect of corporate taxes on the incentive to invest.[42]

While the United Kingdom continues to drop its corporate tax rate, it still has a comparatively high effective marginal tax rate relative to OECD countries. According to the

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[40] See "UK announces a further corporate tax rate reduction," Deloitte, European Tax News Alert (Dec. 10, 2013), *available at* http://www.pwc.com/us/en/tax-services-multinationals/newsletters/european-tax-newsalert/uk-announces-further-corporate-tax-rate-reduction.jhtml.

[41] See Bilicka and Devereaux, "CBT Corporate Tax Ranking 2012," Oxford University Centre for Business Taxation, *available at* http://www.sbs.ox.ac.uk/centres/tax/Documents/reports/CBT%20Tax%20Ranking%202012.pdf.

[42] See id.

study, this ranking is mostly due to the lack of generosity of allowances for capital expenditures: among the OECD countries, only Chile has less generous allowances.[43]

This study drives home the point that all pieces of a tax system must be pro-growth. Thus, as Congress strives to reform the tax code and create a more pro-growth business environment, the Chamber urges that cost recovery provisions be given appropriate attention.

Research and Development Costs

The Chamber has long advocated that research and development (R&D) expenses should be deductible in the year incurred and a larger credit for increases in research expenditures should be allowed. Further, as other countries expand R&D benefits, the Chamber believes we should consider how the tax code impacts the decision whether to conduct research and development in the United States and, also, where the ensuing intellectual property that is created is located.

Congress first enacted the R&D credit in 1981, finding that "a substantial tax credit for incremental research and experimental expenditures [would] overcome the resistance of many businesses to bear the significant costs of staffing, supplies, and certain computer charges which must be incurred in initiating or expanding research programs."[44] Congress has extended the research credit fifteen times since then, most recently in early 2013 as part of tax legislation addressing the "fiscal cliff."[45] Legislative history surrounding extension concludes that "[a] research tax credit can help promote investment in research, so that research activities undertaken approach the optimal level for the overall economy."[46]

While the United States once was a leader in R&D incentives, it has slipped significantly in recent years. A recent study by the Information Technology and Innovation Foundation found that, in 2012, the United States ranked just 27th out of 42 countries studied in terms of R&D incentive generosity, a downward movement from its 23rd ranking of just five years ago.[47] A February 2012 Deloitte report notes that a significant number of countries now "offer the critical operational prerequisites for successfully conducting effective research and development (R&D)," and, further, are even "promoting relocation of R&D operations as part of their innovation-led economic development strategies."[48]

The Chamber believes that innovation is a crucial long-term driver of growth and jobs. Any reform to the tax code should contain incentives for companies to conduct research and development activities in the United States and locate the resulting intellectual property within

[43] See Bilicka and Devereaux, "CBT Corporate Tax Ranking 2012," Oxford University Centre for Business Taxation, *available at* http://www.sbs.ox.ac.uk/centres/tax/Documents/reports/CBT%20Tax%20Ranking%202012.pdf.
[44] H.R. Rep. No. 97-201, pt. 1, at 106 (1981).
[45] Public Law No. 112-240.
[46] Staff of J. Comm. on Taxation, 104th Cong., General Explanation of Tax Legislation Enacted in the 104th Congress 105 (Comm. Print 1996).
[47] The Information Technology and Innovation Foundation, "We're 27th! The United States Lags Far Behind in R&D Tax Incentive Generosity" (July 2012), *available at* http://www2.itif.org/2012-were-27-b-index-tax.pdf.
[48] Deloitte, "2012 Global Survey of R&D Tax Incentives" (February 2012).

U.S. borders.

INVESTMENT

The Chamber has long suggested that investment taxes should be minimized.

Capital Gains

There are detrimental impacts to high capital gains taxes. Currently, individual long term capital gains are taxed at a top rate of 20%. Since the beginning of 2013, capital gains income also has been subjected to the Medicare HI tax, adding another 3.8% tax to the capital gains tax rate. Corporate capital gains rates are even higher, at 35%.

Higher capital gains rates hurt investment. According to the CBO[49] and studies,[50] increasing capital gains rates could create a "lock-in effect" where investors avoid higher taxes by not selling assets. If investors are unwilling to sell taxable assets, the lock-in effect can reduce economic growth by preventing the reallocation of capital to more efficient investments. Further, as the CBO notes, "reductions in capital taxation increase the return on investment and therefore the formation of capital. The resulting increase in the capital stock yields greater output and higher incomes throughout much of the economy."

Further, lower capital gains taxes have significant economic effects on economic growth, jobs and unemployment, inflation, savings, the financial markets, and debt. A 2010 study by Allen Sinai[51] indicates that the net effect of lower capital gains taxation is a significant plus for U.S. macroeconomic performance. The study found that hiking capital gains tax rates would cause significant damage to the economy, reducing growth in real GDP, raising the unemployment rate, and significantly reducing productivity. The study concluded that these losses outweigh any gains in tax receipts from an increased capital gains rate. Further, the study concluded that higher capital gains taxes would not substantially reduce the deficit.

In sum, higher capital gains pose serious risks to the economy. Accordingly, the Chamber strongly urges that any comprehensive tax reform consider the adverse impact higher investment taxes have on investment levels, economic growth, unemployment rates and productivity.

Dividend Taxes

Currently, dividends are taxed at a top rate of 20%. As with capital gains taxes, dividends are also subject to the Medicare HI tax, adding another 3.8% tax to the dividend tax rate.

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[49] See CBO, Capital Gains Taxes and Federal Revenues (October 2002), available at http://www.cbo.gov/doc.cfm?index=3856&type=0.

[50] See Heritage Foundation, Web Memo 1891, Economic Effects of Increasing the Tax Rates on Capital Gains and Dividends, available at http://www.heritage.org/research/reports/2008/04/economic-effects-of-increasing-the-tax-rates-on-capital-gains-and-dividends#_ftn2.

[51] See Sinai, Capital Gains Taxes and the Economy, available at http://www.accf.org/publications/139/capital-gains-taxes-and-the-economy.

As with capital gains taxes, there are detrimental impacts to increased dividend taxes. According to the Tax Foundation,[52] higher dividend tax rates disadvantage the largest dividend-paying companies and reduce the level of dividend paid to shareholders. Further, a September 2010 J.P. Morgan study[53] concludes that higher dividend taxes create a disadvantage for dividend-paying companies and may cause companies to alter their current dividend strategies. This could lower the amount of dollars by which companies ordinarily increase their dividends and could reduce the stock value for all shareholders. If this happens, all taxpayers who receive dividend income would be affected by discouraging investment in dividend-paying companies and potentially lowering dividend payouts.

The same J.P Morgan study[54] concludes that increased dividend rates could increase economic instability. The study finds that an increase in the dividend tax rate would lead to a higher pre-tax cost of equity. As a result, equity valuation might be under pressure, corporations may reduce their investing due to higher hurdle rates, and debt might become more attractive relative to equity. Further, the study concludes that increasing tax rates on dividends can make investing in stocks less attractive to investors and can reduce a stock's perceived value. This decrease in perceived value coupled with the fact that interest on debt is a deductible corporate expense could cause companies to opt to finance new investments through debt offerings rather than stock issuances. Thus, as a result of this increased incentive to use debt financing, businesses may significantly increase debt levels as they attempt to optimize capital allocation. These increased debt levels could cause greater instability in the economy and increase risk of failure.

As with increased capital gains rates, increasing investment taxes in the form of higher dividend taxes comes with many adverse consequences. Thus, the Chamber strongly urges that investment taxes be kept as low as possible to avoid damaging economic ramifications.

CERTAINTY

The Chamber believes that any reform considered by Congress should address the uncertainty that currently plagues the business community under the current Code, largely due to the temporary nature of so many business tax provisions.

As noted in the National Taxpayer Advocate's 2012 Annual Report to Congress, [55] there have been approximately 4,680 changes to the tax code since 2001, an average of more than one a day.[56]

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[52] See Tax Foundation, The Economic Effects of the Lower Tax Rate on Dividends, available at http://www.taxfoundation.org/publications/show/26384.html.
[53] See J.P. Morgan, Unintended Consequences: How higher investor taxes impact corporate finance decisions, available at http://defendmydividend.com/docs/unintended-consequences-vfinal.pdf.
[54] See id.
[55] See National Taxpayer Advocate, 2012 ANNUAL REPORT TO CONGRESS, *available at* http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Volume-1.pdf.
[56] See also Hearing Statement of Senator Max Baucus (D-Mont.), Regarding Changes in the Tax Code since the 1986 Tax Reform Act, *available at* http://finance.senate.gov/imo/media/doc/03012011%20Baucus%20Hearing%20Statement%20on%20Changes%20in

As members of Congress are well aware, the annual exercise by Congress to temporarily extend vital business provisions, such as the research and development (R&D) tax credit, the active financing exception, the controlled foreign corporation (CFC) look-thru rule, and the deduction for state and local sales tax, is an arduous and time-consuming task. The uncertainty surrounding these provisions hinders businesses' ability to most efficiently make decisions, such as those related to hiring employees and making capital investments.

The Chamber therefore urges that changes to the Code as part of comprehensive tax reform be permanent to ensure certainty for businesses striving to expand, create jobs, and remain competitive in the United States and abroad. However, the Chamber also adheres to its longstanding policy that the tax policy process be conducted in an open manner which allows for public comment. Thus, should changes be necessary in the future as a result of findings made during the tax policy process, the Chamber urges Congress to ensure that the tax policy process allows for the implementation of those changes.

COMPLIANCE

The Chamber believes that Congress should enact simple, predictable, and easy to understand tax rules to improve compliance and reduce the cost of tax administration.

As noted in the National Taxpayer Advocate's 2012 Annual Report to Congress,[57] the code imposes huge compliance burdens on taxpayers. The report notes that the code totals almost 4 million words. As a result of this complexity, taxpayers spend an estimated 6.1 billion hours per year complying with tax filing requirements. In 2010, the estimated compliance cost was $168 billion. As this report clearly indicates, these compliance costs are unduly burdensome.[58]

The burdens brought by the complexity of our code also harm the global competitiveness of American worldwide companies. Companies must engage in complex tax planning and deal with outdated and inefficient tax provisions simply to compete in the global economy. These

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%20the%20Tax%20Code%20since%201986%20Reforms.pdf (noting that, since 1986, the code has seen over 15,000 changes, and, at the end of 2010, contained 141 temporary provisions which generally require annual renewal by Congress).

[57] See National Taxpayer Advocate, 2012 ANNUAL REPORT TO CONGRESS, *available at* http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Volume-1.pdf.

[58] See id. The report also notes "individual taxpayers find return preparation so overwhelming that about 59 percent now pay preparers to do it for them. Among unincorporated business taxpayers, the figure rises to about 71 percent. An additional 30 percent of individual taxpayers use tax software to help them prepare their returns, with leading software packages costing $50 or more. For 2007, IRS researchers estimated that the monetary compliance burden of the median individual taxpayer (as measured by income) was $258." See id (footnotes omitted). See also Dave Camp, Chairman, House Ways and Means Committee, Letter to Paul Ryan, Chairman, House Budget Committee, *available at* http://images.politico.com/global/2013/03/10/fy14_budget_letter_from_wm.html (dated 3/6/13) (noting burdensome nature of current tax code).

compliance burdens cause valuable resources to be diverted from productive investments to addressing compliance burdens, an inefficient allocation of resources.[59]

Thus, as Congress considers comprehensive tax reform, the Chamber believes such reform should provide simple, predictable, and easy to understand tax rules to improve compliance and reduce the cost of tax administration. By enacting less complex tax rules, Congress could significantly reduce compliance costs and reduce the tax gap without levying new onerous and punitive taxes.

EFFICIENCY

The Chamber is vitally interested in business of all types and sizes, because of the special role each segment of the business system plays in our economy. Thus, the Chamber will not support any tax reform proposal where a specific sector, industry, or income group disproportionately bears the burden of paying for tax reform. Rather, the Chamber believes that comprehensive tax reform should strive to create a code that allows the marketplace, and not the tax system, to allocate capital and resources appropriately.

TRANSITION RULES

The Chamber believes that a critical component of tax reform debate is how to transition to the new tax regime. Thus, tax reform should include transition rules to provide adequate time for implementation of any new system of taxation and to help minimize economic hardships businesses may encounter in moving to a new tax system.

Generally, these transition rules[60] must give consideration to issues including, but not limited to, treatment of existing deferred tax assets and liabilities, impact on asset valuation, treatment of existing debt, and impact on methods of accounting for existing inventory. In the international arena, consideration must be given to issues such as the treatment of untaxed earnings, the treatment of unused foreign tax credits, and the impact of potential border tax adjustments.

A NOTE ON RETIREMENT ISSUES

The Chamber believes that maintaining current tax incentives for retirement saving is critical. Eliminating or diminishing the current tax treatment of employer-provided retirement plans would jeopardize the retirement security of tens of millions of American workers, impact the role of retirement assets in the capital markets, and create challenges in maintaining the quality of life for future generations of retirees. While we work to enhance the current private retirement system and reduce the deficit, we must not eliminate one of the central foundations –

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[59] See Dave Camp, Chairman, House Ways and Means Committee, Letter to Paul Ryan, Chairman, House Budget Committee, *available at* http://images.politico.com/global/2013/03/10/fy14_budget_letter_from_wm.html (dated 3/6/13).

[60] For a discussion of transition rule issues in tax reform, see Foster, Tax Foundation, "Principles and Practice of Tax Reform Transition," Background Paper No. 23, *available at* http://taxfoundation.org/sites/taxfoundation.org/files/docs/650b130d58b4ed525549effef358a0fc.pdf.

the tax treatment of retirement savings – upon which today's successful system is built. Doing so would imperil the existence of employer-sponsored plans and the future retirement security of working Americans.[61]

CONCLUSION

The Chamber appreciates the opportunity to comment on comprehensive tax reform. We believe that considerations of scoring issues, tax rates, international issues, compliance burdens, the impact of uncertainty, and transition rules are essential components in the conversation on comprehensive tax reform. We look forward to working with Congress, the Committee, and the working group members as this process continues to make improvements to the code to create a tax environment that is increasingly pro-business and pro-growth.

[61] Additional and more detailed comments on retirement issues in tax reform are being submitted under separate cover.

Small Business Tax Reform: Growth Through Simplicity

House Small Business Committee

Wednesday, April 10, 2013

Submitted by:

The Computing Technology Industry Association (CompTIA)

515 2nd Street, NE

Washington, DC 20002

Computing Technology Industry Association (CompTIA)
515 2nd St NE
Washington, DC 20002

Introduction.

Tax burdens and compliance costs consistently force small and medium-sized (SMB) information technology (IT) companies to divert needed resources away from their core businesses, restricting growth and innovation. Reducing the financial burden on these firms via tax reform would promote additional growth and opportunities for the SMB IT industry and eliminate hurdles within the tax code that are limiting the industry's ability to remain globally competitive.

While the SMB IT industry strongly supports closing unfair loopholes and outdated deductions as a means of increasing revenue for broader reforms, there are several key tax provisions that incentivize growth and innovation. Removing these provisions would significantly hamstring SMB IT's ability to grow and strengthen the economy.

This testimony provides an overview of the industry and highlights the key tax policies for the IT industry within four tax reform principles:

1. Simplify the tax code.
2. Reduce the tax burden on the SMB IT industry.
3. Incentivize growth and innovation.
4. Protect SMB IT from new interstate tax compliance burdens.

The data compiled for this report are largely the result of an annual survey CompTIA conducts of its members.

About CompTIA.

The Computing Technology Industry Association (CompTIA) is the voice of the world's $3 trillion information technology industry. CompTIA membership extends to more than 100 countries. Membership includes companies at the forefront of innovation along with the channel partners and solution providers they rely on to bring their products to market and the professionals responsible for maximizing the benefits that organizations receive from their technology investments. The promotion of policies that enhance growth and competition within the computing world is central to CompTIA's core functions. Further, CompTIA's mission is to facilitate the development of vendor-neutral standards in e-commerce, customer service, workforce development, and ICT (Information and Communications Technology) workforce certification. CompTIA is also the leading global provider of IT workforce vendor-neutral certifications. Currently there are over 1.4 million CompTIA IT vendor-neutral certification holders worldwide, and many of those are for IT security.

CompTIA's members include thousands of small computer services businesses called Value Added Resellers (VARs), as well as nearly every major computer hardware manufacturer, software publisher and services provider. Our membership also includes thousands of individuals who are members of our "IT Pro" and our "TechVoice" groups. Further, we are proud to represent a wide array of entities including those that are highly innovative and en-

trepreneurial, develop software, and hold patents. Likewise, we are proud to represent the American IT worker who relies on this technology to enhance the lives and productivity of our nation.

A Vital Contributor to the Economy.

The IT industry in the United States remains a vital contributor to the domestic economy. Currently, the industry comprises about 26 percent (or $950 billion) of the $3 trillion global industry. Through innovation and growth, domestic IT firms have remained globally competitive and economically strong.

SMBs within the IT industry employ some 1.8 million workers, while spending approximately $110 billion annually on payroll. Generally, these are high-paying jobs that rely on skilled workers who continually adjust their skills to meet market trends.

Many of these SMB companies operate within what is referred to as the IT channel. The IT channel spans the IT marketplace between the vendor and the end-user and forms a bridge between distributors, resellers, integrators and consultants. Seventy-five percent of all IT products and services, representing more than $350 billion, are sold to businesses through the channel as opposed to through retailers or direct sales. The vast majority of IT firms in the channel are small and medium-sized enterprises.

Although the industry remains strong, there is significant potential for additional growth. According to January 2013 statistics from Indeed.com, more than 265,000 IT-related jobs are currently available. While this reflects a clear skills gap among potential employees, it also highlights the current job growth in IT firms.

While a range of policies may impact the state of the industry, few have a larger impact than the current tax code. Despite good intentions, too many outdated our unfair policies have proven to hamstring growth within the industry. Given the impact that SMB IT business has on the economy, ensuring the tax code promoters growth for domestic IT should be a key goal in any tax reform efforts.

Principle 1: Simplify the Tax Code.

The tax code has continued to become increasingly complex and complicated, especially for SMB IT companies that do not have the resources to maintain large internal accounting and legal departments. As the tax code has grown, the cost of compliance (and potential for mistakes) has increased rapidly. Both sides of the political aisle have identified the need to simplify the tax code as a key priority.

A recent CompTIA survey found that 48 percent of IT executives identify complexity and the burdens associated with managing taxes as their primary concern with U.S. tax policy. Further, the survey found payroll tax filings to be the most costly and complicated tax requirements for businesses. In this survey, the SMB IT industry has identified a number of tax provisions that would clearly benefit from reforms that reduce the complexity of the tax code.

- *Recommendation:* Payroll Tax Filing Simplification. Employers are generally required to file Form 941 on a quarterly basis to report and pay federal income tax withholdings, social security and Medicare tax. Very small employers with an annual liability of $1,000 or less are allowed to replace these quarterly filings with a single annual Form 944. Increasing this $1,000 threshold would allow more small businesses to file annually instead of quarterly, which would significantly reduce the cost of compliance and risk of error. CompTIA recommends increasing this threshold to $50,000, which will provide compliance burden relief for the majority of the 5.8 million[1] small businesses employing 1–99 employees.

Principle 2: Reduce the Tax Burden on the SMB IT Industry.

According to the U.S. Economic Census, 67 percent of IT services firms, including employer and non-employer businesses, pay taxes at individual rates as a sole proprietor or pass-through entity. Therefore, it is important that tax reform does not adversely affect these small businesses. While a corporate tax rate reduction remains very popular among SMB IT companies (63 percent believe it would be an important policy), the direct impact to pass-through entities would be tangential. However, the economic implications of a corporate tax rate reduction (and its impact on adjacent industries) would likely have a positive impact on SMB IT companies depending on the broader tax policies adopted.

We also note that SMB IT companies cite a reduction in payroll tax as a top issue. While income tax liability might fluctuate, virtually all of the SMB IT industry must pay payroll taxes, associated with its $110 billion annual payroll. The most direct way to lessen the burden on these businesses is to provide a reduction in the employer's share of these taxes. This would make it easier and less costly to add new workers.

- *Recommendations:* Comparable Tax Treatment for Sole Proprietor and Pass-Through Entities. Within comprehensive tax reform, a variety of tax provisions, including a corporate tax rate reduction, will be on the table. While the IT industry may be impacted to varying degrees depending on the combination of the various reductions, it is important that any solution provide comparable rate reduction for entities that are sole proprietors and pass-through entities. Ignoring these important economic engines—by simply reducing the corporate tax rate alone—would continue to hamstring the ability of the SMB IT to grow and prosper. We also recommend a reduction in the employer's share of payroll taxes; this will encourage businesses to hire more workers, which will in turn lead to economic growth for our nation.

Principle 3: Incentivize Growth and Innovation.

[1] *According to the 2008 U.S. Census, there were a total of 5,821,277 small businesses employing approximately 42 million employees with an annual payroll of over $1.5 trillion*

The SMB IT industry relies on its ability to grow and remain innovative. Many of the largest IT companies in the U.S. started as small businesses that succeeded through constant innovation and investment. Unfortunately, many of these small start-up IT firms are economically unable to continue to make these innovation investments.

The SMB IT industry believes the tax reform debate must include discussion of all tax provisions. In fact, executives surveyed indicated that certain deductions and loopholes were a major issue impacting tax policy. However, there are tax benefits that are meaningful to economic growth and provide a pathway to innovation for the SMB IT industry.

- *Recommendations:*
  - R&E Tax Credit for Small Businesses: Most small start-up companies do not show a profit, and thus do not have an income tax liability against which to offset the traditional R&E tax credit. Therefore, some of the most vital and innovative companies cannot receive any economic benefit from the traditional R&E tax credit. Accordingly, CompTIA supports legislation that would allow start-up companies to offset a simplified R&E tax credit against payroll tax liability.
  - Bonus Depreciation: Bonus depreciation promotes investment and growth by businesses and has been especially important to small businesses. While the economy shows signs of improvement, small businesses need continuing support to grow their businesses. For 2011 and 2012, businesses were allowed an additional 100 percent bonus depreciation. This limitation has been extended through 2013, but will expire beginning in 2014. CompTIA calls on Congress to permanently extend bonus depreciation at the 100-percent level.
  - Small Business Expensing: Section 179 allows small businesses to deduct the cost of certain asset purchases, as opposed to requiring the cost to be capitalized and depreciated over a period of years. This enables small businesses to invest in technologies that improve both productivity and the quality of goods and services. The current limitation of $500,000 per year will drop to $25,000 after 2013. CompTIA strongly supports a permanent extension of the $500,000 limitation.

Principle 4: Protect SMB IT from New Interstate Tax Compliance Burdens.

As state budgets face ever-increasing pressures to raise revenues, state tax authorities must become more creative in their collection efforts. While states should not be limited in their ability to tax transactions within their jurisdiction, it is important that this emerging regime of taxation not unfairly impact the IT and tech industries, especially SMBs. Additionally, it is important that new state tax laws do not create unfair and duplicative taxes on SMB

IT companies, imposing additional compliance costs on sellers and their customers.

- *Recommendations:*

  - Small Business Exemption for Internet Tax Collections: For any legislation that would require out-of-state sellers to collect and remit sales taxes, CompTIA supports a robust small business exemption. Small businesses are less capable of bearing the costs of a new tax compliance requirement. CompTIA believes the debate should be refocused to balance the rights of states to collect sales taxes with the ability of small businesses to cover these new compliance costs. States have a right to collect sales and use taxes owed, but the costs associated with shifting this compliance burden onto small businesses also must be weighed. Small businesses that provide goods and services remotely are as vital to our economy as those small businesses that reside in and make sales within a single state.

  - Digital Download Taxation: Consumers, vendors and taxing authorities need a consistent rule to determine which state/jurisdiction is permitted to impose a tax on the purchase of a digital product or service. Currently, there is no certainty concerning which jurisdiction has the authority to tax these products among the location of the customer, seller's server and customer's home address. This creates the potential for multiple and discriminatory taxes on the purchase of digital goods and services. Therefore, CompTIA supports proposals that would restrict collection of sales taxes on digital goods and services to the jurisdiction encompassing the consumer's tax address, while also prohibiting multiple and discriminatory taxes. We believe this is a simple and objective criterion that will bring both certainty and lower compliance costs for taxpayers, vendors and taxing authorities.

  - Business Activity Taxation: While physical nexus (having an office or place of business in the state, or employing workers that operate within the state) continues to control sales and use tax collections, some states now are seeking to tax any transaction that has an "economic nexus" to that state. CompTIA supports enactment of a distinct physical presence requirement as a prerequisite for the taxation of business activities. That is, states should not be permitted to tax businesses that do not have a physical presence or workforce within that state. Permitting states to reach out to impose tax collections and reporting on non-resident small businesses that have no contact with that state would impose an unaffordable compliance burden, especially on the SMB IT industry.

Conclusion.

The strength of the IT industry relies on its ability to grow, innovate and adjust to market trends. SMB IT companies across the nation are providing services to all major industries from healthcare to agriculture. The success of these industries relies on the IT industry and the services they provide.

The U.S. IT industry continues to add jobs and strengthen the economy. Additionally, we are remaining competitive in a rapidly evolving global marketplace. While the industry remains strong, we must continually identify ways to mitigate the burdens on these companies in an effort to increase their growth potential, which translates into sustaining and generating high-paying jobs.

Therefore, tax reform should be a mechanism to promote additional growth and opportunity for the SMB IT industry and eliminate hurdles within the tax code that are limiting the industry's ability to remain globally competitive.

Promoting Responsible Sun Care and Sun Burn Prevention.

2025 M STREET, NW • SUITE 800
WASHINGTON, DC 20036
PHONE: 888-377-0477
FAX: 202-367-2142
WWW.THEITA.COM

Comments to the House Committee on Small Business
By the Indoor Tanning Association
Regarding the Small Business Tax Reform Discussion Draft of March 12, 2013

April 10, 2013

The Honorable Sam Graves
Chairman
Committee on Small Business
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

On behalf of the more than 140,000 Americans working in the indoor tanning industry, I would like to thank you for your hard work toward crafting a tax code that is simpler and fairer for the nation's small businesses. The Indoor Tanning Association (ITA) represents thousands of indoor tanning manufacturers, distributors, facility owners and members from other supporting industries, and we applaud the tireless efforts of the Committee and its staff.

As you are well aware, high tax rates and a complicated tax code impose a disproportionately severe burden on small businesses. Tax compliance and preparation costs alone saddle small businesses, most of which do not have in-house tax professionals, with an enormous liability. The result is less money invested into growing the business and hiring employees. This is a drag on the nation's still-sputtering economy, both inhibiting job growth and depressing wages for those fortunate enough to even have a job.

A simpler and fairer code would have a tremendous impact not only on the indoor tanning industry and other small businesses across the spectrum, but on the U.S. economy overall given that small businesses employ roughly half the nation's workforce and have historically led the country out of recessions. The ITA is pleased that this discussion draft includes several provisions designed to ease the burden on the indoor tanning industry. Specifically, we support the simplification and expansion of cash accounting methods for taxpayers that satisfy the new gross receipts test; increased Section 179 expensing; and unified deductions for startups, among others.

One additional tax issue that we feel must be addressed in the context of tax reform is the 10% excise tax on tanning services being used to fund the Affordable Care Act, otherwise known as

the Tan Tax. This tax has serious consequences for small businesses and their employees. The Tan Tax undermines thousands of small businesses across the United States, unfairly targeting the industry and harming millions of consumers, workers, and job-creating small business owners.

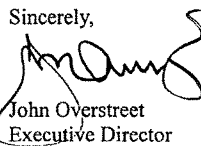
Indoor tanning businesses have paid this unfair tax for nearly three years, and the unsurprising yet disappointing results are in. 1,570 tanning businesses have closed since 2010, resulting in the loss of 9,420 American jobs. This includes dozens of business closures in Missouri alone, causing hundreds of job losses locally. Nationally, the picture is even more dire.

Moreover, this regressive tax hits some of those least able to afford it the hardest, specifically working women (who are not only customers but also make up a majority of our business owners) and college students (who are both customers and employees).

The need to review the Tan Tax is especially pressing in light of the fact that neither the Ways and Means Committee nor the Finance Committee had the opportunity to review this tax during the healthcare reform debate. Therefore, on behalf of the 140,000 Americans working in the indoor tanning industry, I ask that you encourage the House Committee on Ways and Means to seize the opportunity of tax reform to repeal the job-killing Tan Tax.

I commend your leadership and your tireless efforts toward thoughtfully helping craft a tax reform plan that creates a simpler and fairer code. The Indoor Tanning Association looks forward to working with the Small Business Committee and the Congresss as this long-overdue process continues to unfold.

Sincerely,



John Overstreet
Executive Director

CC: The Honorable Nydia Velazquez, Ranking Member

4226 King Street, Alexandria, VA 22302
P 703-845-9000 F 703-845-8176
www.nata.aero

April 12, 2013

Chairman Sam Graves
Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Graves:

Thank you providing the National Air Transportation Association (NATA) with the opportunity to submit written comments for the Small Business Committee's hearing on House Ways and Means Committee Chairman Dave Camp's discussion draft to reform our cumbersome tax code in order to help small businesses succeed.

NATA's more than 2,000 members consist of companies that own, operate and service aircraft and provide for the needs of the traveling public by offering services and products to aircraft operators and others such as fuel sales, aircraft maintenance, parts sales, storage, rental, airline servicing, flight training, Part 135 on-demand air charter, fractional aircraft program management and scheduled commuter operations in smaller aircraft. NATA members are a vital link in the aviation industry providing services to the general public, airlines, general aviation and the military.

First, let me express my gratitude to Chairman Camp for issuing a discussion draft of a tax reform plan for small businesses. Throughout the years, our tax code has become increasingly more difficult and temporary. Taxpayers, predominantly small business owners, have felt the effects of the constantly changing codes and the expenses that accompany proper filing. Chairman Camp's discussion draft offers a simpler, fairer tax code that leads to more jobs and higher wages.

Chairman Camp's suggestion to make permanent the ability for small businesses to deduct investments on new equipment and property would be welcomed by the business community. Without this legislation, investment levels for new equipment and property will remain stagnant or regress.

The unification and simplification of tax rules outlined in the discussion draft should promote greater compliance by small businesses as well.

Chairman Camp's draft will create a less costly, more efficient and more uniform tax collecting system that will provide small businesses with power and opportunities similar to those of larger businesses through job production and growth, the ability to increase wages for its workers and strengthen income and productivity.

Chairman Sam Graves
April 12, 2013
Page 2

Without action that addresses the heavy burden small businesses carry in complying with the existing tax code, it will be very challenging to grow the small business sector. NATA strongly supports the efforts of Chairman Camp and looks forward to working with him and the Small Business Committee in reforming our burdensome and complicated tax code.

I also bring to the attention of the Small Business Committee the difficult situation that many of our NATA members find themselves in with respect to the Internal Revenue Service's (IRS) lack of clear and precise guidance on the applicability of Federal Excise Taxes (FET) to aircraft management services. This situation is causing angst and uncertainty regarding the companies' potential FET liability. Since aircraft management companies are secondarily liable for FET, we believe the Service should provide clear guidance, consistent with applicable law, before imposing liability for these taxes.

NATA will soon request the Department of Treasury to include this issue on its 2013-2014 Guidance Priority List and that ongoing IRS audits with respect to this matter be placed on hold until clear and precise guidelines can be developed.

Again, Chairman Graves, thank you for providing NATA the opportunity to comment on Chairman Camp's small business discussion draft and other tax issues, as well as your Committee's ongoing efforts to help small businesses across the Nation.

Sincerely,

Thomas L. Hendricks
President and CEO

National Association of
Chemical Distributors

Advancing **Stewardship,** Creating **Connections**™

April 9, 2013

The Honorable Sam Graves
Chairman, House Committee on Small Business
2361 Rayburn House Office Building (RHOB)
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for holding a hearing on the important issue of the tax treatment of small businesses, and for allowing the National Association of Chemical Distributors the opportunity to submit comments for the record. NACD members process, formulate, blend, re-package, warehouse, transport, and market chemical products exclusively for an industrial customer base of more than 750,000. NACD members operate in every state in the continental U.S. and throughout all of North America through more than 1,500 facilities. Most NACD members are small businesses. The typical member is privately-owned with $26 million in annual sales, 3 facilities, and 28 employees. More than 40 percent of NACD members are family-owned. NACD members demonstrate our commitment to product stewardship through compliance with Responsible Distribution, our mandatory and third-party verified environmental, health, safety, and security program.

Like many industry sector associations, many different parts of the tax code affect our members. There are two specific issues, however, that we wish to focus on in these comments.

Protecting Pass-through Entities from Effective Higher Rates

It is essential that, if the tax code is simplified, it also be comprehensive. Any tax reform proposal considered by Congress must include individual as well as corporate tax reform. The issue is of immense importance to the financial health of NACD's membership; a recent survey of our membership found that slightly more than 50 percent of chemical distributors are pass-through entities.

Since many business deductions and credits are used by both corporate and pass-through businesses, their elimination in exchange for corporate-only rate reduction would result in a tax increase for a large number of chemical distributors who pay taxes as individuals. As Congress considers lowering the corporate tax rate, it also must address the rate of those businesses that operate as pass-through entities. Like corporations, pass-through entities face nearly the highest rate among industrialized countries on business income. Under the individual code, pass-through entities face a top marginal rate of 39.6%, even higher than the 35% rate faced by C corporations.

Small businesses are job creators in the country, and form a critical role in our economic health. There are important non-tax business reasons for choosing to operate as a pass-through entity, including the flexibility it affords in setting up the business structure and financing. Thus, retaining the ability of small business to operate as pass-through entities is an important economic and societal goal. If tax rules

1555 Wilson Blvd., Suite 700 Arlington, VA 22209 P: 703.527.6223 F: 703.527.7747 nacd.com

currently used by both corporate and pass-thru businesses are eliminated, and rates are reduced only for C Corporations, then pass-thru businesses will realize tax increases. While reducing the tax burden on business will certainly help foster a more robust economic recovery, a subset of businesses should not face tax increases to accomplish this goal. This will not only negatively affect a majority of chemical distributors, it will negatively the economy as small businesses struggle to compete.

Preserving the Last-In, First-Out Inventory Accounting Method

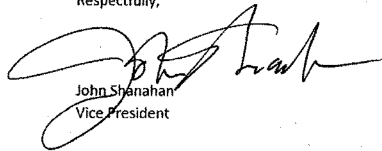
NACD supports retaining the last-in, first-out (LIFO) inventory method as part of any legislation to address tax reform. A repeal of the LIFO method will reduce growth, reduce investment in property, plant & equipment, and will curtail employment. The issue is of great importance to many chemical distributors. A recent survey found nearly one-quarter of our membership uses the LIFO method.

LIFO is an inventory accounting method that has been in the tax code for 70 years. It assumes the inventory used to establish a value for "Cost of Goods Sold" or CGS is from the last inventory acquired. The corollary of this statement is that the inventory identified on the balance sheet is the oldest inventory acquired. Many businesses have used LIFO accounting for decades. LIFO allows businesses to exclude inflationary gains from holding inventories from taxable income. Similar to real property that is held and has appreciated in market value, however, this inventory appreciation is unrealized. LIFO allows a company to retain the working capital needed to be able to replace the same physical amount of goods that a company would normally carry with new stock. Put another way, the LIFO method of accounting allows chemical distributors to match their current sales revenues with current inventory replacement costs.

The repeal of LIFO would be a retroactive tax. Companies currently using the accounting method would be subject to a one-time tax on their LIFO reserves and higher tax bills in the future. By creating a sizable tax penalty for having chosen a particular accounting method sometimes decades earlier, eliminating LIFO effectively would be a retroactive tax. It would drain small businesses of a substantial amount of their accumulated net worth. Businesses bearing this retroactive tax would struggle to maintain employment and investment for an extensive period of time following a repeal of LIFO. This reduction of net worth would occur from taxes on inflation gains over differing lengths of time, depending on the company. During any phase out period, many small businesses would be hesitant or unable to make new investments in facilities or equipment.

Mr. Chairman, the role and impact of tax structure is of immense importance to businesses generally, but particularly so to the health of small businesses. Thank you for giving your attention to this very important small business issue.

Respectfully,



John Shanahan
Vice President

National Association for the Self-Employed

Legislative Office
325 7th Street, NW, Suite 250
Washington, DC 20004
P: 202-466-2100
F: 202-466-2123
www.NASE.org

Statement for the Record
Submitted to the Committee on Small Business
United States House of Representatives
Washington, D.C.

Submitted by Kristie Arslan
President & CEO, National Association for the Self-Employed
April 10, 2013

The National Association for the Self-Employed (NASE) respectfully submits this official statement for the record on today's hearing, "*Small Business Tax Reform: Growth Through Simplicity.*" The NASE represents the 22 million self-employed and micro-business owners (10 employees or fewer), providing educational resources for those looking to start and grow their businesses. Founded in 1981, the association has been the sole voice advocating for America's small businesses in all areas of public policy, especially in the area of the tax inequities faced by the self-employed, for the past 30 years.

For background purposes, we would like to put into context the role of the self-employed in the small-business community. At present, there are roughly 27 million small businesses nationwide, ranging from 1 to 499 employees and of those, **22 million are identified as self-employed, accounting for more than 78 percent of the entire small-business community, generating roughly $950 million dollars annually in sales** (*2010 Non-Employer Statistics, U.S. Census Bureau*). The majority of the self-employed, roughly 56 percent, have their business organized as a sole-proprietorship, and thus any significant tax reform in the corporate area will have little if any impact on the self-employed.

On behalf of our members, of which 78 percent indicated overwhelming support in a 2012 survey on tax reform, the NASE is in favor of comprehensive tax reform, in order to create a simplified tax code that treats all businesses fairly while also removing unnecessary hurdles and streamlining a cumbersome and overwhelming tax filing process. So strong is the call for reform that in 2012, 96 percent of our members deemed individual and corporate tax reform as a "very important or moderately important" issue for Congress to address in 2013.

Yet lawmakers largely ignore the self-employed in proposed reforms. The NASE fully understands that the Ways and Means small-business draft is not inclusive of all potential recommendations for reform, but we are concerned that the draft seems to be completely void of any proposals that would address the continued disparity faced by the self-employed under the current tax code. In blunt terms, only one of the four components has any bearing on the self-employed community, *Unified Deduction for Start-Up and Organizations Expenses*. And it is ironic that the framework for the unified deduction is included in H.R. 886, *Small Business Tax Relief Act of 2013*, which includes an additional six other tax measures that the small-business draft overlooks (**Note:** the small business draft does include the permanent expensing provision which is included in H.R. 866).

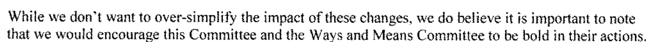
Due to our concern, the NASE has met with various tax staff members to discuss additional items that we encourage the House Committee on Ways & Means as well as the House Committee on Small Business to consider as they near finalizing draft legislation reforming the tax code. True to his word, Chairman Camp has led a transparent process for his reform efforts, which is to be applauded, and we are hopeful that our recommendations will be strongly considered and included in the final text of the overhaul tax reform proposal.

The following are additional tax proposals put forth by the NASE:

1. Deduction of health insurance costs for the self-employed as a qualified business expense by adding a line item on the Schedule C form and not on page one of Form 1040;
   - ➢ The biggest tax inequity faced by the self-employed continues to be their inability to deduct the cost of the health insurance as a qualified business expense. This amounts to roughly $1,800 in additional taxes per year for self-employed individuals.
2. Amend the definition of "employee" to include the owner and spouse of a sole proprietorship, or a 2 percent or greater shareholder in an S Corporation – a simple legislative or administrative fix to current language;
   - ➢ This would address many issues related to "fringe benefits," for example: the applicability of an HRA 105 plan, retirement plan contributions, and health insurance premiums.
3. Simplified and streamlined definition of independent contractor versus employee by expanding the Form 1099 that requires the owner and contractor to agree to their business relationship in a transparent manner;
   - ➢ Reduction of abuse by business owners and their use of independent contractors.
4. Simplified depreciation calculators, reporting requirements, and accelerated options for most standard business items and amounts, all of which would be included as a line on the Schedule C form;
   - ➢ In developing simplified deduction calculators, the business owner would be able to easily apply for the correct deduction amount and simplify a process that is currently unnecessarily complicated.
5. Building off the simplified home office deduction, identify other areas to establish standard deduction options based on industry and location, resulting in the development of a Standard Schedule C-EZ form.
   - ➢ Recognizing the difficulty in creating standard deductions, we believe that if the necessary time and energy were directed towards creating such a system, the taxpayer would benefit enormously. This has the opportunity to becoming the greatest tool towards simplifying the tax code for small business owners.

All of the above proposals meet the criteria of creating a lean, simplified, equitable tax code – inspiring entrepreneurship and growth within the small-business community.

While we don't want to over-simplify the impact of these changes, we do believe it is important to note that we would encourage this Committee and the Ways and Means Committee to be bold in their actions.



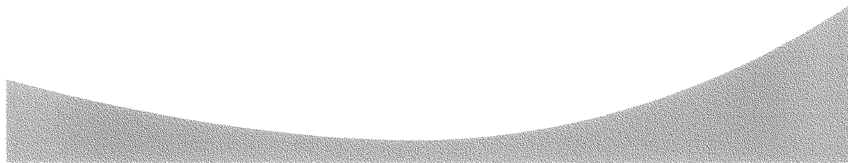
It goes without saying that any significant reform to the tax code will be challenging, but we believe that putting forth a dynamic, common-sense proposal for bringing the tax code into the 21st Century can be accomplished if the proposal provides for a transformational change to all aspects of the tax code, individual and corporate.

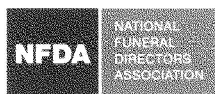
As it stands now, our concern remains that the draft proposal looks only to modify or tweak the current tax code, but falls short of taking a path to overhauling the dysfunctional and byzantine tax code with a vision for complete reform of the individual and corporate tax structure.

We look forward to continuing to work with the Small Business and Ways and Means Committees on achieving comprehensive tax reform in the 113th Congress.

Respectfully

Kristie Arslan, CEO & President
National Association for the Self-Employed





April 7, 2013

Honorable Dave Camp
Chairman, Ways and Means Committee
United States House of Representative
Washington, DC 20515

Dear Chairman Camp:

On behalf of the National Funeral Directors Association and its 20,000 members, I want to add our voice in support of the Committee's efforts to reform the current tax code to make it simpler and fairer to small business. The current tax code inhibits, in many ways, the ability of our members to grow, prosper and better serve the families in their communities.

In that regard, we are encouraged by the draft proposal titled "***Strengthening the Economy and Increasing Wages by Making the Tax Code Simpler and Fairer for America's Small Businesses***". NFDA is particularly supportive of the sections dealing with 179 expensing, cash accounting and reforming and updating the partnership and Subchapter S rules. We also like moving the filing dates for business tax returns.

NFDA looks forward to working with you and the Committee on these and other proposals that will benefit small business.

Sincerely,

John H. Fitch, Jr.

John H. Fitch, Jr.
Senior Vice President, Advocacy
National Funeral Directors Association

National Grocers Association

April 10, 2013

Dear Chairman Graves, Ranking Member Valazquez, and Members of the Committee:

The National Grocers Association (NGA) appreciates this opportunity to submit for the record the following statement for the House Small Business Committee's hearing: "Small Business Tax Reform: Growth through Simplicity". We commend the Committee for its work on this important topic that impacts every single business like no other issue does. NGA also commends Chairman Camp and the members of the House Ways and Means Committee for their tireless work and continued commitment to tax reform.

NGA is the national trade association representing the 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 a variety of formats. Most independent operators are serviced by wholesale distributors, while others may be partially or fully self-distributing. Some 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 dedicated to their customers, associates, and communities. NGA members include retail and wholesale grocers, state grocers associations, as well as manufacturers and service suppliers.

The independent supermarket channel represents over $129 billion in annual sales while providing quality jobs to over 944,000 workers with wages exceeding $30 billion annually. All told independent grocers and their employees generate $27 billion in state and federal taxes, while operating on an average profit margin of around 1 percent.

NGA welcomes an open debate on reforming the nation's complex and cumbersome tax code. However, reform must be balanced and fair. Recently, NGA undertook a comprehensive tax survey of our member companies which produced a number of key findings that NGA believes are critical elements in understanding how tax policy impacts the independent grocery sector as it works to create jobs and grow the economy. Responses were diverse and reflective of NGA's membership and ranged from a single store operator with annual sales just over $2 million to a wholesaler with annual sales around $6.5 billion. The business tax structures of NGA members are diverse, representing C-Corporations and pass-through entities such as S-Corporations, LLCs, Partnerships, and ESOPs.

1005 North Glebe Road #250 • Arlington, VA 22201-5758 • (703) 516-0700 • FAX: (703) 516-0115
Website: http://www.NationalGrocers.org

As a result of this survey, NGA developed three tax principles which must be considered as Congress addresses tax reform.

Principle #1: Tax Reform Must be Fair & Equitable for all Business Entities.

Tax reform must simultaneously include relief for both pass-through entities such as S-Corporations and also C-Corporations and must include parity. When tax rates rise, such as the recent increase in individual tax rates to 39.6%, there is less cash for investment. As one respondent noted, lenders are requiring large sums of cash to qualify for loans, further highlighting the importance of cash flow. In an industry where the average profit margin is only around 1 percent, every penny counts. NGA's members made it clear that a direct correlation existed between higher tax rates and the adverse impact on their ability to service debt, invest in stores, expand distribution centers, acquire new equipment, and hire workers without going deeper into debt.

NGA's members are family-owned and / or privately controlled businesses, many having served their local communities for decades so it is not surprising that the adverse effect of the estate tax was ranked of high importance by survey respondents. Well over half of the assets of a typical supermarket are not liquid, so the death of an owner creates a serious obstacle for continuation of the business. Additionally, the estate tax is a reality that independent grocers must face in which their publically traded competitors never face.

Respondents also strongly support continuation of the long standing and widely used Last-In, First-Out (LIFO) accounting method. LIFO repeal would have a devastating impact on the industry for those that have considerable reserves, especially in the case of a wholesaler who operates as a cooperative. In this case, LIFO repeal would cause a trickle-down effect in the industry by reducing the equity of retailers, including many small businesses, who are the owners of the cooperative. Simply put, the LIFO accounting method is not a tax provision and repeal would create a "phantom tax" that does not meet the basic standards of fairness and equity.

Principle #2: Tax Provisions that Encourage Capital Investment in Businesses Should be Retained to Continue Creating Jobs and Growing the Economy.

Over 90 percent of survey respondents specifically cited their ability to use provisions such as bonus depreciation and section 179 expensing to provide the cash flow to replace old fixtures, build new stores, remodel existing stores, and invest in energy saving equipment. The 15 Year Straight-Line Recovery for Qualified Leasehold Improvements was also rated important to 89 percent of our members. These investments have a positive impact on local economies and jobs through product procurement and installation, while often leading to increased sales

allowing retailers to hire more workers. NGA believes strongly that these pro-growth provisions should be retained to promote economic growth and create jobs.

Principle #3: Incentives to Expand Employment Opportunities and Business Investment in Underserved Communities Should be Maintained.

The Work Opportunity Tax Credit (WOTC) was cited by respondents as a valuable tool for hiring workers who often face barriers to employment. Additionally, the New Markets Tax Credit (NMTC) program was identified by a number of respondents and is a provision that is becoming more important to independent grocers as more retailers work in communities that currently lack access to fresh foods.

As the Committee continues to review the important issue of tax reform, NGA urges you to take into consideration the concerns of independent grocer, many of whom are small businesses. Attached for the record is NGA's report, *Principles of Tax Reform for the Independent Grocery Sector* which provides a more in-depth analysis to the anecdotes mentioned above. If you have any questions or need additional information please do not hesitate to contact me or Greg Ferrara, Vice President of Public Affairs, at gferrara@nationalgrocers.org.

Sincerely,

Peter J. Larkin
President and CEO

2013

Principles of Tax Reform

For the Independent Grocery Sector

NGA
NATIONAL GROCERS ASSOCIATION

Thirty years ago, the National Grocers Association (NGA) was born and has since been recognized as the representative of the independent retail and wholesale grocer. I'm pleased to report that the industry thrives due in large part to the entrepreneurial spirit that has spurred tremendous growth, even in these current challenging economic times. In fact, independent retail and wholesale grocers are responsible for over 945,000 direct quality jobs with wages exceeding $30 billion annually, while generating over $27 billion in state and federal taxes. We look forward to sharing more positive economic data at the end of April 2013 when NGA's economic impact study of the independent supermarket industry is released.

While the independent grocery industry is strong, it is not without its challenges, especially during these economic times. According to the 2012 Independent Grocers Financial Survey, published by NGA and FMS, the average net profit for independent grocers before taxes was just 1.12%. The supermarket industry is hypercompetitive with many different operators and formats competing for the same consumer dollar, made even more challenging at a time when the economy remains weak. Independent retailers and wholesalers must continue to reinvest capital back into their businesses to keep stores fresh, to take advantage of new opportunities to expand their operations, and improve efficiency.

Many try to simplify tax reform into a one or two sentence talking point that often fails to reflect reality. It's important for public policy makers to clearly understand the "faces" that operate behind the Internal Revenue Code and understand how tax provisions present challenges as well as opportunities for economic and job growth, especially for small and medium size businesses who are the cornerstone of thousands of communities across the nation.

In March 2013 NGA asked its members to provide their business insights into a number of specific categories regarding tax reform such as tax rates, capital investments, and other pro-growth tax provisions. Their candid responses have been summarized in this report and should be considered as Congress continues to address tax reform. Independent retail and wholesale grocers help drive America's economy and are responsible for hundreds of thousands of local American jobs. It is our hope that the information provided in this report will provide valuable insights into those elements that are crucial to ensuring that businesses, such as independent retail and wholesale grocers, are able to continue investing their hard earned capital back into their businesses in an effort to spur economic growth and job creation.

We look forward to continuing to work together to reform the tax code in a manner that ensures America's independent retail and wholesale grocers are able to continue growing and creating much needed jobs.

Sincerely,

Peter J. Larkin
President and CEO

The Independent Supermarket Industry

Independent retail and wholesale grocers are the true entrepreneurs of the grocery industry and are dedicated to their customers, associates, and communities. A vibrant independent sector promotes diversity in the marketplace and increases consumer choice in price, variety, quality, service and value.

The meaning of an independent retailer is more of a question of ownership and philosophy of operation, rather than a number of stores or type of format. An independent retailer is a privately owned or controlled food retail company operating a variety of formats. A few may be publically traded, but with controlling shares held by the family, and others are employee owned.

The independent grocery channel is a marketplace that is highly competitive, labor intensive, cash flow dependent, very sensitive to a broad range of tax provisions and low margin. In fact, according to the 2012 NGA / FMS Independent Grocers Financial Survey the average net profit before taxes for independent retail grocers was only 1.12%.

Independent Grocers Drive Local Economies & Create Quality Jobs

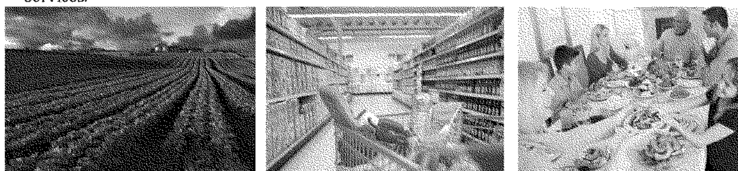
Independent grocers impact communities in virtually every community across the Nation, responsible for over 945,000 quality jobs with wages exceeding $30 billion. Annual sales of retail and wholesale grocers exceed $125 billion annually. The impact of the local supermarket is felt from the fields of America's farmers to our family's dinner table.

The importance of independent grocers is seen far beyond their direct employees. Over 147,000 people in the United States work in firms that supply that the infrastructure and other services to the grocery industry including agriculture, physical infrastructure such as refrigeration equipment, technology, insurance, real estate services, and legal services.. Additionally, over 422,000 people in the United States owe their jobs to the re-spending of the direct and indirect wages of the independent grocer industry. All told, independent retail and wholesale grocers and their employees generate over $27 billion in state and federal taxes.

The National Grocers Association

The National Grocers Association (NGA) is the national trade association representing the retail and wholesale grocers that compromise the independent sector of the food distribution industry. Also represented are affiliated associations, manufacturers, and service providers as well as other entrepreneurial companies that support NGA's Mission and Philosophy.

NGA's mission is to ensure independent, community-focused retailers and wholesalers the opportunity to succeed and better serve the consumer through its policies, advocacy, programs and services.



Executive Summary

Between March 4, 2013 and March 11, 2013 the National Grocers Association undertook a comprehensive tax survey of its member companies. The survey produced a number of key findings that NGA believes are critical elements in understanding how tax policy significantly affects the job creators in this key industry sector. Responses to the survey were diverse and reflective of NGA's membership, ranging from a single store operator with just over $1 million in annual sales to a wholesaler with over $6.5 billion in annual sales.

Principle #1: Tax Reform Must be Fair & Equitable for all Business Entities.

It's clear from responses that tax rates have the most direct impact on a business owner's ability to reinvest capital back into the business. Respondents indicated 57% operate as pass-through entities while 37% operated as a C-Corporation, highlighting the importance of tax reform addressing both individual rates and corporate rates. Any tax reform effort must simultaneously include relief for both pass-through entities and C-corps and must include parity. When tax rates rise, such as the increase in individual tax rates to 39.5%, there is less cash for investment. As one respondent noted, lenders are requiring large sums of cash to qualify for loans, further highlighting the importance of cash flow. In an industry with the average net profit before taxes is only 1.12% every penny counts.

Additionally, 88% of respondents cited the Death Tax as important to their business continuity. NGA's members are family-owned and / or privately controlled businesses so the death tax is a real threat to their ability to pass the business onto the next generation. The Death Tax impacts independent grocers particularly hard as well over half of the assets of a typical supermarket are not liquid, meaning the surviving heirs are often faced with securing an expensive loan to selling part or all of the business to pay the tax. While the current Death Tax exemption provided a level of certainty and some relief to NGA's members NGA's ultimate goal remains to see this onerous tax repealed.

Accounting Method Last In, First Out *is Widely Used*

Nearly 60% of respondents indicated that the accounting method Last In, First Out (LIFO) was important to their business. Many retailers and wholesalers have been on LIFO accounting for many years, including one respondent who has relied on LIFO for 66 years. LIFO has been a widely accepted accounting practice since 1939 and should be preserved as an accepted accounting method under tax reform. It's clear from the survey responses that repeal of LIFO would have a devastating impact on many in the industry.

Principle #2: Tax Provisions That Encourage Capital Investment in Businesses Should be Retained to Continue Creating Jobs and Growing the Economy

Bonus Depreciation was rated by 93% of respondents as important, while 89% rated section 179 expensing as important. Comments from survey respondents specifically cited their ability to use these provisions to provide cash flow to replace old fixtures, build new stores, remodel stores, and invest in energy saving equipment. The 15 Year Straight-Line Cost Recovery for Qualified Leasehold Improvements was rated by 82% of respondents as important for store upgrades. These investments have a positive impact on local economies and jobs through product procurement and installation, while often leading to increased sales allowing retailers to hire more workers.

Principle #3: Incentives to Expand Employment Opportunities and Business Investment in Underserved Communities Should be Maintained

Work Opportunity Tax Credit and New Markets Tax Credit

The Work Opportunity Tax Credit (WOTC) was cited by 60% of respondents as important and was valuable in hiring workers who often face barriers to employment, while 37% of respondents indicated the New Markets Tax Credit (NMTC) was important. NMTC are becoming more important to independent grocers as more retailers work to address the issue of food deserts.

Tax Structures

Respondents represent a diverse range of business tax structures with S-Corporations being the dominate response at 48% followed by C-Corporations at 37%. A growing segment of respondents and our members are electing to become ESOPs.

Survey Respondent Tax Structure Breakdown:

C-Corporation	37%
S-Corporation	48%
ESOP	1%
LLC / Partnership	8%
Other	3%
No Response	3%

Individual & Corporate Tax Rates

Respondents were asked to rate the importance of tax rates to their business. Overwhelmingly, both C-Corps and S-Corps and other pass-through respondents cited a direct correlation between higher taxes and the adverse effect on their ability to service debt, reinvest in stores, distribution centers, equipment, and people without going deeper into debt. The current disparity between individual tax rates for pass-through entities and C-Corps results in unfair and inequitable taxation of business income. One S-Corp ESOP respondent specifically cited the detrimental impact taxing passive entities with certain revenue thresholds as C-Corps and would have a direct, negative impact on our employee owners.

Rate the importance of tax rates and any impact, if any, they have on your business.

Very Important	67%
Important	12%
Somewhat Important	9%
Not Important	1%
Not Applicable	10%

Comments:

"Taxes are the most significant cost that we incur."

"There is a direct correlation between the amount of taxes we pay and the amount of funds we have for capital investment."

"Trying to manage the tax rate doesn't allow us to grow our business effectively and create new opportunities for our associates and create more jobs."

"Being an S corporation, the profits from our company are reflected as personal income to us; however, we do not actually earn this as personal income (does not go into our pockets). The Company's retained earnings go into growth; plant renovations and personnel benefits."

"I try on average to reinvest 20% of my income in plant and equipment improvement each year. With state and federal taxes approaching 50% I am not left with much to invest in additional business opportunities."

"As an LLC it is a challenge to pay high taxes in light of the constant necessity to accumulate resources to use when purchasing equipment or paying for a remodel in a store. The loan to value rates require large sums of cash to qualify for lending, 50% for inventory, 30% for equipment, 30% for buildings. When taxes have taken up cash capital projects are directly impacted."

The Death Tax

The Death Tax remains an important issue for independent retail and wholesale grocers with 88% of survey respondents identifying the issue as important. NGA's members are family-owned and / or privately controlled businesses, many having served their local communities for decades. Well over half of the assets of a typical supermarket—the highest of any other industry sector—are not liquid, so the death of an owner creates a serious obstacle to continuation of the business. Because the estate tax of up to 40% is assessed on the value of a business at the owner's death, it often forces families to borrow funds to pay the tax, and hampers a family-owned businesses' ability to pass the company to the next generation. As a result it reduces the ability to invest and grow the business, or forces the sale of the business. Additionally, the Death Tax is a reality that independent grocers must face in which their publically traded competitors never face.

The current Death Tax exemption of $5.25 million ($10.5 million per couple), indexed to inflation with stepped up basis, provides some relief to family-owned retailers and wholesalers, while also providing much needed certainty. NGA's ultimate goal remains to see this onerous tax with a top rate of 40% repealed.

Please rate the importance of death taxes on your business. Background: Death Tax top rate increased 5% to 40% in 2013, with an exemption of $5.25m / $10.5 couples indexed to inflation, portability of any unused portion to surviving spouse, and stepped up basis.

Very Important	59%
Important	20%
Somewhat Important	9%
Not Important	5%
Not Applicable	6%

Comments:
"As a family-owned business we spend a lot of money on tax planning and life insurance to mitigate the impact of this tax instead of using these dollars to drive associate and customer satisfaction"

"Our family-owned business started from nothing and now because we have been successful we will be forced to sell or refinance to pay the taxes when our father passes."

"We are a small 4th generation family-owned business. We have spent substantial resources on lawyers, accountants, and planners to try and set-up a structure that can deal with estate taxes. We are very concerned that we may have to sell our business just to pay the taxes and end a 68 year old company."

Capital Gains / Dividends

In today's economy investment in a supermarket requires substantial capital costs in buildings, equipment and real estate. Capital gains tax rates that are lower than ordinary income tax rates promote capital investment in businesses in order to encourage long term businesses and economic growth. **A differential between capital gains and ordinary income tax rates was rated as important by 88% of survey respondents to their ability to grow their businesses.**

Please rate the impact Capital Gains and Dividend Taxes have on your business. Background: Capital Gains / Dividends rates below $400,000 / $450,000 (couple) currently are 15% while increasing to 20% above the $400,000 / $450,000 threshold. On January 1, 2013 an additional 3.8% tax went into effect for individuals with incomes above $200,000 / $250,000 couples. This also pertains to "passive" investment income from flow-thru entities.

Very Important	59%
Important	19%
Somewhat Important	10%
Not Important	5%
Not Applicable	6%

Comments:

"The increase in capital gains from 15 to 20% will be a deterring factor in my decision to invest in my business. With the additional 3.8% tax on top of the income tax increases, the prospects for growth in my company are quite poor. Raises for my employees have been greatly impacted by these recent (tax) increases."

"The capital gains tax is a penalty for running a profitable business as it, along with the dividend taxation, ends up being a double tax."

Capital Investments

Independent retail and wholesale grocers require significant capital in order to reinvest in and grow their businesses. Equipment for a typical supermarket requires a substantial capital investment that can quickly grow into six figures, even for a small store, and easily exceeds $1 million for many larger stores and wholesale distribution facilities. Capital investments include replacement or upgrades to refrigeration cases, shelving, fork lifts, and technology to operate front end cash registers as well as backend systems to manage inventory and cash flow. Wholesale distribution facilities require millions of dollars of capital in equipment, racking systems, trucks and trailers, and sophisticated technology to manage logistics and inventory control. Importantly, capital investment in our member's facilities has a positive impact on the local economy. Capital investment by independent retailers and wholesalers has a multiplier effect as equipment and services are often secured from local providers, helping to grow the local economy and create jobs.

Bonus Depreciation

In tough economic times pro-growth tax provisions such as bonus depreciation have helped independent retailers and wholesalers continue to purchase new equipment and reinvest in their businesses by being able to write off the investment at a faster rate. **Bonus depreciation was identified by 93% of respondents as important to their ability to reinvest in and grow their businesses.** Many survey respondents also cited the positive impact provisions, such as Bonus Depreciation, had on cash flow for use in capital investments.

Please rate the importance of Bonus Depreciation on your ability as a retailer or wholesaler to reinvest and grow your business.

Very Important	48%
Important	31%
Somewhat Important	14%
Not Important	3%
Not Applicable	5%

Comments:
"We remodeled one of our stores and took advantage of this (provision). We also spent a million dollars last year on new equipment."

"We have used this incentive to replace old equipment and help to grow our business. Small companies need this to help stretch our limited budgets in hard times. The more we invest in equipment and remodels the more Americans have jobs."

"This program has allowed us to modernize our aging stores and better compete with the large chains. We need Bonus Depreciation to invest in new technology and energy saving equipment."

"We have depended on Bonus Depreciation to make approximately $300,000 of capital improvements over the past year. We have replaced technology, installed new refrigeration cases, equipment, and various machinery."

"We have upgraded our facilities over the past few years and believe that none of it would have been possible if normal depreciation rules were applied. A lot of capital that we used would have gone to pay taxes. It has made our company strong and should help us stay viable for many years."

"We were able to build a brand new store in 2008 using Bonus Depreciation. We have continued to purchase new equipment to help production and improve safety at our facility."

"Helps small business reinvest in their stores at a time when our economy needs to be spurred on."

Section 179 Expensing

Similar to bonus depreciation, 89% of survey respondents also rated Section 179 expensing for qualified purchases as a very important tax provision given the positive impact it has had on independent retailers and wholesalers' ability to reinvest in their businesses and grow.

Section 179 expensing is essential to providing many retailers with increased cash flow for capital investments. While some wholesales noted that the provision was not applicable to them give the threshold phase-out, but it was very important to their retail customers who were able to reinvest and grow their businesses, thereby having a positive net effect on the wholesaler as well. A number of respondents urged that the maximum threshold of $500,000 for qualified purchased be increased to encourage further investment. Lowering the threshold would likely lead to decreased investment.

Rate the importance of the section 179 deduction for qualified purchases up to a maximum of $500,000 and a phase-out threshold to $2 million in 2012-2013. Taxpayers may also expense up to $250,000 of the cost of qualified leasehold improvement.

Very Important	44%
Important	31%
Somewhat Important	14%
Not Important	4%
Not Applicable	8%

Comments:
"I have added equipment each year because of this!"

"We need to know what is going to happen before it's too late to react like last year's tax package. It was too late to spend money when we found out the tax package was going to go through. Fear caused us to hold back."

"Need more qualified purchases."

"Would like to see maximum raised."

"Deduction has allowed us to make needed improvements in a tight economy."

*Note: Many respondents cited many of the same reasons given under the Bonus Depreciation question.

Credit: Grocery Headquarters Magazine

15 Year Straight-Line Cost Recovery for Qualified Leasehold Improvements

The 15 Year straight-line cost recovery for qualified leasehold improvements was cited as an important provision by 82% of survey respondents for independent grocers remodeling and reinvesting in their facilities. Specifically the provision is important to independent grocers from a cash flow perspective; however a number of respondents noted that 15 years is still long and a shorter period would be more advantageous.

Please rate the impact on your business of the 15-Year Straight-Line Cost Recovery for Qualified Leasehold Improvements. Note: provision is extended through 2013 and includes the 15 year cost recovery period for qualified leasehold, restaurant, and retail improvements / new buildings established prior to January 1, 2014.

Very Important	31%
Important	32%
Somewhat Important	19%
Not Important	6%
Not Applicable	13%

Comments:

"Makes upgrading my stores easier"

"Have used this a lot, a shorter period would be better"

"This is very important to our retail owners"

"From a cash-flow perspective it is very important"

"Having to go 39 years is awful, this makes more sense"

Acceptable Accounting Method

Last In, First Out (LIFO)

Proposals by President Obama and some in Congress would repeal the accounting method Last In, First Out, commonly referred to as LIFO. Contrary to what some have characterized as a "gimmick" LIFO is a widely accepted accounting practice recognized by the Internal Revenue Service since 1939.

Historically, in time of high food price inflation many independent retail and wholesale grocers chose the Last In, First Out (LIFO) accounting method to more accurately valuate their inventory replacement cost. Over the years many independent retailers and the wholesalers that serve them have built up considerable LIFO reserves, which are neither cash nor assets and by no means are liquid. Repealing LIFO and taxing a company's reserves would have a devastating impact on most respondents.

While a number of independent retailers use LIFO, so too a large number of wholesalers use LIFO and have considerable reserves. In the case of those wholesalers who are cooperatives, the impact of repeal and taxing their LIFO reserves would be felt by their independent retail grocer owners,

thereby causing a trickle effect by effectively reducing the equity position of those retailers. NGA strongly supports maintaining the LIFO accounting method.

Please rate the importance of the accounting method, Last In, First Out (LIFO). If you do not use LIFO please select "Not Applicable". Background: President Obama has repeatedly called for LIFO to be repealed, forcing companies to "write up" their LIFO reserves.

Very Important	22%
Important	18%
Somewhat Important	19%
Not Important	17%
Not Applicable	24%

Respondents were asked to provide their current LIFO reserves. Responses ranged from a low of $40,000 to a high of $6.7 million. A large number of responses listed reserves in excess of $1 million. In terms of years on LIFO the responses ranged from a low of 4 years to a high of 66, with most responses in the 20 - 30 year range.

Comments:
"I am not sure how we would pay for that. We do not have those kinds of (cash) reserves. We would have to evaluate a loan and if that could not be done we may be forced to sell one or two of our stores."

"If this happens there would be a fire sale on this business."

"The impact on our company would be huge."

"We would mail our keys to the IRS"

"We operate as a cooperative (wholesaler). This would trigger very high taxes paid should we have to recognize our valuation allowance."

"Would possibly be forced to sell the company."

"Very important for our wholesaler. We are not using LIFO, but our member owned wholesaler is and it is very important for our co-op."

Miscellaneous Pro-Growth Tax Provisions

Work Opportunity Tax Credit (WOTC)

Over 60% of survey respondents cited the Work Opportunity Tax Credit (WOTC) as important to their business. Predictably, respondents are reflective of the businesses particular geographic location and how their operations function. Additionally, larger operations seemed more inclined to utilize the credit given the administrative burdens required to administer the program, which may be more than a smaller operator is able or willing to undertake, given the threat of penalties for errors. Other respondents were not familiar with the credit. One respondent located in the Gulf region cited the important role WOTC played in the aftermath of Hurricanes Katrina and Rita; however it has become less important due to lack of qualified employee candidates. NGA has long supported WOTC and is a member of the WOTC Coalition.

Please rate the importance of the Work Opportunity Tax Credit (WOTC) to your business. Background: the WOTC is extended through 2013 allow business to claim a tax credit equal to 40% of the first $6,000 of wages paid to new hires in certain targeted groups.

Very Important	13%
Important	23%
Somewhat Important	24%
Not Important	32%
Not Applicable	8%

Comments:

"We have been able to put many at-risk individuals or persons who otherwise might not have an opportunity to work."

"Haven't used WOTC, as it's difficult to find qualified folks in targeted groups in my rural community."

"The penalty for mistakes is not worth the trouble"

"Would like to see this program extended"

"We've hired about 10 people through this program"

"We have hired 4 employees over the last 10 years on this program. Two have been here for 10 years! Would never have taken a second look had it not been for this program, and they turned out to be excellent employees."

"Have hired an estimated 25 people"

"We definitely use this program and it has allowed us to continue to operate in an area that we may have had to review profitability more closely."

New Markets Tax Credit (NMTC)

As more of NGA members are investing in communities located in food deserts the New Markets Tax Credit (NMTC) has become a key tool that has enabled numerous urban projects. Independent grocers in Pennsylvania, New York, California, Illinois, the City of New Orleans, and Mississippi are participating in efforts to bring supermarkets and economic development to areas that have lacked access, in addition to new store projects that are ongoing in numerous communities across the country due, in part, to NMTC resources.

The NMTC program is relatively new to many independent grocers, which may explain the large number of respondents who rated the program as either "not important" or "not applicable".

If you have utilized the New Markets Tax Credit (NMTC) please rate the importance to your business. The NMTC program is extended through 2013 enabling businesses and individuals that make private investments in low income communities a 39% tax credit spread over 7 years.

Very Important	7%
Important	13%
Somewhat Important	17%
Not Important	39%
Not Applicable	24%

Comments:

"Good program, just not an issue in our marketplace"

"Working on a project now that will use NMTC, the project is in a tough area and the business model would not work financially if this program and county resources were not available. I would like to see money geared toward smaller businesses."

"Have not used this, but have investigated and will use if still available in 2014."

"This credit has been utilized by several of our owners and assisted in the development of new independent grocery stores. As a company we have not utilized the Federal New Markets Tax Credit, but our sales have benefited through retail use of the credit."

"We purchased a store from a developer who was able to use this (NMTC) to finance the development."

"We are currently looking at this program for a possible expansion in 2014."

National Grocers Association
1005 North Glebe Rd. Ste 250
Arlington, VA 22201
www.nationalgrocers.org

Staff Contacts:

Peter Larkin
President and CEO
703-516-0700
plarkin@nationalgrocers.org

Tom Wenning
Executive Vice President and General Counsel
703-516-8805
twenning@nationalgrocers.org

Greg Ferrara
Vice President Public Affairs
703-516-8811
gferrara@nationalgrocers.org

Statement

NPES The Association for Suppliers of Printing, Publishing and Converting Technologies

Small Business Tax Reform: Growth through Simplicity

Submitted to the

Committee on Small Business

United States House of Representatives

April 15, 2013

The Association for Suppliers of Printing, Publishing and Converting Technologies

1899 Preston White Drive • Reston, Virginia 20191-4367 • 703/264-7200 • Fax: 703/620-0994
E-Mail: npes@npes.org Internet: http://www.npes.org

Statement Summary

NPES The Association for Suppliers of Printing, Publishing and Converting Technologies

Small Business Tax Reform: Growth through Simplicity

Submitted to the

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I. NPES Urges Pro-growth Tax Reform as Essential to Economic Recovery and Sustained Economic Security

II. NPES and the Graphic Communications Industry

III. 100 Percent Expensing Spurs Investment, Creates Jobs and Promotes Economic Growth

IV. 100 Percent Expensing Should Not Compete with Other Pro-growth Tax Reforms

V. Retain the Current Federal Estate Tax Exemption Levels or Repeal the Tax Completely

VI. NPES Stands Ready to continue to Work with Congress and the Administration to Achieve the Vital Goal of Tax Reform that Promotes Efficiency and Economic Growth.

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I. NPES Urges Pro-growth Tax Reform as Essential to Economic Recovery and Sustained Economic Security

NPES The Association for Suppliers of Printing, Publishing and Converting Technologies urges pro-growth tax reform as essential to a more robust economic recovery and sustained economic security, and commends House Ways and Means Committee Chairman Dave Camp for his leadership in advancing comprehensive tax reform designed to achieve these ends at this critical time in our nation's history. NPES also commends House Small Business Committee Chairman Sam Graves and Ranking Member Nydia Velazquez for their additional efforts to solicit additional views on Chairman Camp's Small Business discussion draft. NPES believes the goal of tax reform should be to promote efficiency and economic growth, and that Chairman Camp is exactly right to in include tax reform provisions designed to strengthen the economy by helping smaller businesses expand operations, hire new workers and increase wages. To that end, NPES commends and supports his proposals that would both simplify and make permanent tax laws critical to smaller businesses. These attributes, simplification and permanency, will greatly reduce current costs of tax compliance and facilitate business planning for the future.

II. NPES and the Graphic Communications Industry

NPES The Association for Suppliers of Printing, Publishing and Converting Technologies is a U.S. trade association whose over 550 member companies are engaged in the manufacture and importing for sale or distribution of machinery, equipment, systems, software and supplies used for design, assembly, production and distribution of information by companies in the graphic creation, design, prepress, package printing/converting, finishing and publishing industries. NPES member companies provide the technological foundation for one of the largest industries in the United States – graphic communications. Five hundred and fifty NPES members provide the essential equipment and supplies for an industry that includes more than 47,000 firms, employs nearly one million people, and records over $156 billion in annual

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E-Mail: npes@npes.org Internet: http://www.npes.org

sales. While the ongoing shift to electronic communication, along with the recent severe recession and tepid economic recovery have all reduced industry volume and employment, the ubiquitous Graphic Communications industry is still a vital manufacturing employer that plays a critical role in the nation's communication and commerce. And while the graphic communications includes some very large companies, it is also the quintessential small business oriented industry, both in terms of printers and small business customer served by printers, as well as suppliers to the industry, many of which are NPES members who themselves are often relatively smaller companies.

III. 100 Percent Expensing Spurs Investment, Creates Jobs and Promotes Economic Growth

While Chairman Camp's discussion draft contains a number of important reforms for smaller businesses, NPES's focus in these comments is on the pro-growth economic power of capital investment and the proper way to account for it within the tax law. In this regard, NPES believes that the discussion draft's proposal to make permanent IRC Section 179 expensing at pre-stimulus levels, allowing smaller businesses to deduct immediately investments in new equipment and property up to $250,000, with the deduction phased out for investments exceeding $800,000 (with both amounts indexed for inflation), is certainly more preferable than allowing these levels to revert in 2014 to the very inadequate amounts of $25,000 and $200,000 respectively if no action is taken. However, NPES respectfully urges that more could and should be done to reduce the service price of capital, which historically has had a major impact on investment, employment and output. Ideally, this would entail moving to 100 percent expensing for all capital investment in equipment, including printing, publishing and converting technology.

Referring to Section 179 expensing as "small business" expensing is a misnomer in two respects. First, the provision is not limited to "small business" by whatever definition might be chosen for that term. It could just as well be employed by larger firms, but those businesses may find Section 179 inadequate due to its limits on the amount that can be expensed in a single

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E-Mail: npes@npes.org Internet: http://www.npes.org

acquisition, as well as the overall level of capital investment in a given year, which are the restrictions that give rise to the provision being referred to as "small business expensing."

Conversely, it is also quite possible that a "small business," might very well need capital equipment the price of which exceeds $250,000, or that a printer may find it necessary or advantageous from a business perspective to exceed $800,000 in total capital investment in a single year. In either case, the discussion draft Section 179 proposal would not be adequate, and hence our advocacy for 100 percent expensing of all capital investment in equipment as a permanent feature of the tax code.

So while NPES supports the IRC Section 179 proposal in the current Ways and Means Tax Reform Small Business Discussion Draft as preferable to the law reverting to much reduced, and we believe very inadequate levels that would obtain in 2014 if nothing is done, the Association also strongly believes that 100 percent expensing is the correct method of accounting for the service price of job-producing capital investment. A mid-range alternative could be making permanent the bonus depreciation and Section 179 provisions enacted under The Small Business and Work Opportunity Tax Act of 2007, the Economic Stimulus Act of 2008 and the American Taxpayer Relief Act of 2012.

IV. 100 Percent Expensing Should Not Compete with Other Pro-growth Tax Reforms

One hundred percent expensing should not compete with other pro-growth tax reforms. More particularly, giving up expensing or even decelerating depreciation deductions in exchange for other corporate tax reforms, such as rate cuts, should be avoided. Expensing and accelerated depreciation are timing issues that do not decrease tax revenue from the standpoint of the federal budget, and both have long been accepted as most efficient policies that properly encourage and account for capital investment that stimulates job-producing economic growth. They have a demonstrable record of bringing about new, more productive investment leading to greater economic activity that in turn generates greater tax revenues.

1899 Preston White Drive • Reston, Virginia 20191-4367 • 703/264-7200 • Fax: 703/620-0994
E-Mail: npes@npes.org Internet: http://www.npes.org

V. Retain the Current Federal Estate Tax Exemption Levels or Repeal the Tax Completely

After years of changes and uncertainty, Federal Estate Tax rules became clear and stable with the 2012 year-end fiscal cliff legislation, and are for now set permanently into the tax code - at least until the tax code changes again. To the latter point, although not part of the Small Business Discussion Draft, NPES supports the new inflation adjusted Federal Estate Tax exemption levels of $5.25 million (individual) and $10.50 million (couple) as adequate to avoid burdening the generational transfer of most family-owned small businesses and urges that they be maintained going forward in any tax reform effort, as full repeal of the tax remains politically elusive.

VI. NPES Stands Ready to continue to Work with Congress and the Administration to achieve the Vital Goal of Tax Reform that promotes Efficiency and Economic Growth.

In conclusion, NPES is grateful for the opportunity to contribute to the ongoing tax reform dialogue, and urges that the proven economic power of expensing and the vital job creating role of smaller businesses in the economy are fully factored into comprehensive tax reform.To that end NPES stands ready to continue to work with Congress and the Administration to achieve the vital goal of tax reform that promotes efficiency, business planning certainty and economic growth.

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The Association for Suppliers of Printing, Publishing and Converting Technologies

1899 Preston White Drive • Reston, Virginia 20191-4367 • 703/264-7200 • Fax: 703/620-0994
E-Mail: npes@npes.org Internet: http://www.npes.org

NRMCA

April 12th, 2013

U.S. House Representative Sam Graves
Chairman
House Committee on Small Business
2361 Rayburn House Office Building
Washington, D.C. 20515

U.S. House Representative Nydia Velázquez
Ranking Member
House Committee on Small Business
B-343C Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Graves and Ranking Member Velázquez,

On behalf of the National Ready Mixed Concrete Association (NRMCA), we want to thank you for holding your recent hearing on April 10th, 2013 titled "Small Business Tax Reform: Growth Through Simplicity." Keeping taxes low, streamlined, and used to help foster small business economic certainty and growth is vital for the ready mixed concrete industry.

Founded in 1930, today NRMCA represents more than 1,350 member companies and their subsidiaries that employ more than 125,000 American workers who manufacture and deliver ready mixed concrete. NRMCA represents both national and multinational companies, with almost 6,000 plants, that operate in every congressional district in the United States. The industry is currently estimated to include more than 65,000 ready mixed concrete trucks.

The numerous tax provisions outlined in Rep. Camp's discussion draft and repeated throughout the hearing provide an excellent framework to inject much needed common sense approaches for simplifying the small business tax code. NRMCA is currently in the process of working with the NRMCA membership to identify how Rep. Camp's proposal will specifically affect the ready mixed concrete industry.

In addition to Rep. Camp's small business tax provisions we would like to offer an innovative tax provision not mentioned during the April 10th hearing that protects economic vitality, while saving tax payer dollars and lives. To this point, we recommend Rep. Camp incorporate the Disaster Savings and Resilient Construction Act of 2012, which was introduced last Congress on a bipartisan basis, into the tax reform initiative.

In 2011 and 2012, Congress passed Emergency Disaster funding legislation at unfunded levels of $8 billion and $60 billion respectfully. While no one can predict what disasters may occur in the future—and they will happen—areas hit hardest in the past are likely to be impacted again. From Hurricanes along the Gulf and East Coasts to Tornado Alley, the geography is predictable even while the timing is not. However, through advancements in building technology, techniques, and testing, residential and commercial buildings can now be constructed to withstand all forms of natural disasters. Now, when federally declared disaster areas are rebuilt with these new techniques, whole communities are made resilient and are able to recover quickly from inevitable future disasters.

A CBO analysis has found that where federal dollars are spent on pre-disaster mitigation programs, "on average, future losses are reduced by about $3 for every $1 spent on those projects."

When a federal disaster is declared, taxpayers' dollars are used to help rebuild communities and cities around the country. In offering a tax credit to builders and contractors, many of which are small businesses, using resilient construction techniques within a federally declared disaster area, the federal government will save money on future rebuilds. Additionally, homeowners may be eligible for a reduction in insurance costs if their home utilizes resilient construction techniques. According to the Alabama Press-Register, an Alabama homeowner who retrofitted their home to meet resilient standards saw their annual insurance premiums reduced from $3,488 to $1,800 – a $1,688 yearly savings to the homeowner.

Resilient construction has the potential to substantially reduce property damage and loss of life resulting from all forms of natural disasters. In an example from Hurricane Ike, while all other homes in the surrounding area were totally destroyed, 10 of 13 resilient constructed homes in the path of the storm remained standing with minimal damage. The three houses that did not survive actually were destroyed by the impact of debris from traditionally built homes knocked off their foundations by storm surge. It's simple: with more homes standing and less debris flying, more lives are saved.

The Joint Committee on Taxation has scored the Disaster Savings and Resilient Construction Act of 2012 at $2 million over 5 years, and $2 million over 10 years, while reducing future, unfunded disaster spending and saving lives in the process.

Thank you again for holding the April 10th hearing and for taking the time to consider the ready mixed concrete industry's tax priority. We look forward to working with you and Rep. Camp on this important tax initiative.

Sincerely,

Robert A. Garbini
President
National Ready Mixed Concrete Association

NATIONAL READY MIXED CONCRETE ASSOCIATION

900 Spring Street, Silver Spring, MD 20910 888-84-NRMCA Fax: 301-585-4219 email: nrmca@nrmca.org www.nrmca.org

Statement for the Record

of

Dave Koenig, Vice President, Tax and Profitability,
National Restaurant Association

Hearing On

"Small Business Tax Reform: Growth Through Simplicity"

for the

Committee on Small Business
U.S. House of Representatives

April 15, 2013

Enhancing the quality of life for all we serve

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Chairman Graves, Ranking Member Velazquez, and members of the House Small Business Committee, thank you for the opportunity to submit this statement for the record for the recent hearing entitled "Small Business Tax Reform: Growth Through Simplicity." The National Restaurant Association ("The Association") applauds the Chairman, Ranking Member, and Committee for holding a hearing on tax reform that specifically focuses on issues related to small businesses.

Currently, the tax law presents taxpayers with a great deal of complexity, unpredictability and compliance burdens. Looking ahead, tax reform offers an opportunity to provide taxpayers with certainty, simplicity, and fairness, while encouraging economic growth and job creation. Done properly, a comprehensive and nuanced review of the tax system would eliminate those tax policies that detract from these objectives, while promoting those that advance them.

We applaud the Ways & Means Committee along with this Committee for the open and transparent process by which it is approaching tax reform. The association has been working for the past several years to make the case for fair reforms that take the restaurant industry's organizational diversity into account. We believe that marginal tax rates for both individuals and corporations should be reduced as much as possible. We also believe it is important for Congress to examine corporate and individual tax reform simultaneously due to the variety of smaller pass-through entities that make up the majority of restaurant businesses. Moreover, as the Committee moves forward with crafting reform legislation, we would like to bring to your attention several provisions of particular importance to the food service industry. Specifically, we strongly support:

1) Making permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements. This temporary provision clearly comports with the tax reform policy that cost recovery reflect the economic useful life of the taxpayer's investment.
2) Making permanent the Work Opportunity Tax Credit ("WOTC"). WOTC has been very effective helping targeted group members find gainful employment.
3) Retention of the FICA Tax Tip Credit Reimbursement which has been instrumental to enhancing compliance and the accurate reporting of tip income.
4) Making permanent for all restaurant businesses the enhanced charitable deduction for donations of food inventory, which has helped alleviate hunger in the U.S.
5) Restoring the business meal deduction to better reflect the basic principle that business expenses should be fully deductible.

Restaurants: An Industry with a Large Impact on Our Nation's Economy

The restaurant industry plays a significant role in our nation's economy. In 2013, the restaurant industry is expected to reach a record high of $660.5 billion in sales, representing 4

percent of the U.S. gross domestic product. Every dollar spent in restaurants generates an additional $2.05 spent in our nation's economy. The restaurant industry is one of the nation's largest private job creators and is expected to employ approximately 13.1 million people in 2013, representing nearly ten percent of the U.S. workforce. The restaurant industry is expected to add 1.3 million jobs over the next decade reaching 14.4 million by 2023. The restaurant industry job growth outpaced the overall economy in 13 consecutive years, from 2000 to 2012. Average sales in 2010 were $849,000 at a full-service restaurant and $753,000 at a quick-service restaurant. We are truly one of the cornerstones of this nation's economy.

It is also important to stress that the restaurant industry is an industry of small businesses. There are 980,000 restaurant and foodservice outlets in this country. Ninety-three percent of eating and drinking place businesses have fewer than 50 employees and more than seven out of 10 are single-unit operations. In addition, restaurants serve as the conference rooms for many of the self-employed and other small businesses.

Accordingly, as the Committee undertakes its review of the tax code, the association believes it is important to examine corporate and individual tax reform simultaneously due to the restaurant industry's organizational diversity. Since a variety of smaller pass-through entities make up a majority of restaurant businesses, only through comprehensive reform can a truly fair outcome be achieved.

Comments Regarding the Committee Chairman's Small Business and Pass-Through Discussion Draft

On March 12, Ways & Means Committee Chairman Camp released a discussion draft that proposes options for simplifying the tax rules that apply to a wide range of business entities including partnerships, limited liability companies, S corporations and sole proprietorships. While we continue to review many of the framework's proposals, we applaud the Chairman Camp's commitment to reforming the taxation of small businesses.

We believe some of the specific proposals contained in the framework would go a long way toward simplification and reducing taxpayer burden. For example, the discussion draft would make permanent the expensing thresholds under IRC section 179. Specifically, the draft makes permanent the election to deduct the cost of certain property placed in service for the year rather than depreciate those costs over time. The draft sets the maximum dollar amount that may be deducted at $250,000 and the amount at which the deduction phases-out at $850,000, indexed for inflation.

The Chairman's proposal to make the increased limits permanent, to index the amounts for inflation, and to include certain qualified real property in the definition of qualified property furthers simplification, provides predictability and merits serious consideration. We would note that for taxable years before 2014 the limits were set at $500,000 and $2 million. These higher limits were very beneficial to many small businesses in terms of simplification and investment

decisions. We are very pleased that the proposal retains the expanded definition of qualified property includes qualified leasehold improvements and qualified restaurant and retail property.

We will continue to review the small business and pass-through discussion draft and gather input from our members, particularly regarding the two separate options designed to achieve greater uniformity between S corporations and partnerships. In the meantime, we want to bring to your attention several provisions contained in the tax code that directly affect the food service industry and are a priority for the restaurant industry. We hope you will take these comments into consideration as your deliberations continue.

Permanence of the 15-year Depreciation Schedule for Leasehold Improvements, Restaurant Improvements and New Construction, and Retail Improvements

One principle of the tax code is that the cost of assets are allocated over the period in which they are used. Assets with longer expected lives are depreciated over a longer period of time, while assets with shorter lives are depreciated over a shorter period of time. As a reflection of this principle, the tax code contains a provision under which leasehold improvements, restaurant improvements and new restaurant construction, and retail improvements can be depreciated over 15 years rather than a 39-year recovery period that would otherwise apply to nonresidential real property.

With more than 130 million Americans patronizing restaurants each day, restaurant building structures experience daily structural and cosmetic wear and tear caused by customers and employees. Moreover, National Restaurant Association research shows that most franchise contracts require restaurant owners to remodel and update their building structures every six to eight years. Consequently, 15 years is a more accurate timeframe for recovering the cost of investments in restaurant buildings and improvements than is 39 years.

Moreover, a 15-year depreciation schedule reduces the cost of capital expenditures and increases cash flow. As demonstrated in Figure 1 (see next page), the annual tax savings and corresponding additional cash flow realized by restaurateurs from a 15-year, rather than a 39-year, depreciation schedule are considerable. For example, a restaurateur's annual tax liability would increase by nearly $10,000 if the recovery period for a $1 million investment were increased from 15 years to 39 years. A more accurate recovery period frees resources to expand business either through new hires or further capital expenditures.

Figure 1.

Sample Calculations for 15-Year versus 39-Year Depreciation

Total Capital Expenditure on Eligible Property	Annual Depreciation Based on 39-year Schedule	Annual Tax Savings from Depreciation	Annual Depreciation Based on 15-year Schedule	Annual Tax Savings from Depreciation	Annual Difference in Tax Savings Between 15- & 39-year Schedules
$100,000	$2,532	$608	$6,667	$1,600	$992
$250,000	$6,329	$1,519	$16,667	$4,000	$2,481
$500,000	$12,658	$3,038	$33,333	$8,000	$4,962
$700,000	$17,722	$4,253	$46,667	$11,200	$6,947
$1,000,000	$25,316	$6,076	$66,667	$16,000	$9,924
$1,500,000	$37,975	$9,114	$100,000	$24,000	$14,886
$2,000,000	$50,633	$12,152	$133,333	$32,000	$19,848

Note: Figures are based on a 24 percent effective marginal tax rate

Additionally, when restaurants invest in construction and renovations, the impact spreads throughout the economy. Figure 2 (attached at the end of statement) provides state-by-state estimates of the additional spending on restaurant improvements and new construction that would result from an extension of the 15-year depreciation provision in 2013, as well as the overall economic and employment impact within each state.

However, the 15-year depreciation schedule is temporary and must be extended annually. Most recently, it was extended by the *American Taxpayer Relief Act of 2012* retroactive to the beginning of 2012 and through the end of 2013. Consequently, the provision will expire again at the end of this year unless Congress takes action. This piecemeal and temporary approach to the 15-year depreciation schedule, requiring extension every couple of years, presents taxpayers with unnecessary uncertainty and complexity.

In March 2012, the association surveyed a sample of nearly 600 restaurant operators who took advantage of the 15-year depreciation provisions between 2005 and 2011. The survey revealed that 30 percent of restaurant operators said they put projects on hold in 2012 when the provision lapsed because of the uncertainty surrounding the extension of the 15-year depreciation provision. With single-unit restaurant operators reporting an average expected project cost of $40,000, and multi-unit operators reporting an average expected project cost of $500,000, the additional construction activity from these restaurant projects put on hold would have exceeded $7 billion in 2012. Based on economic multipliers from the Bureau of Economic Analysis, the overall economic impact of these restaurant construction projects would have exceeded $23

billion, with a total employment impact of nearly 200,000 additional jobs across all U.S. industries.

Using tax reform to make permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements would address this problem, providing taxpayers with predictability, simplicity, and fairness. The ability to plan for these expenditures and know what the tax treatment will be in the future is important to those who are making business decisions in today's economy.

Permanence of the Work Opportunity Tax Credit

Another important provision in the tax code is WOTC, a tax credit provided to employers who hire individuals from several targeted groups who face significant barriers to employment. Examples of WOTC-targeted employee groups include veterans who either are Supplemental Nutrition Assistance Program ("SNAP", formerly food stamps) recipients or are unemployed and suffering a service-connected disability, former felons, disconnected youth, and members of families receiving benefits under the Temporary Assistance for Needy Families Program ("TANF").

The restaurant industry employs over 13 million people, many of whom may not have been hired if WOTC had not been in place. WOTC encourages employers to hire certain categories of individuals with barriers to employment, enabling these workers to move into self-sufficiency as they earn a steady income and become contributing taxpayers. Through WOTC, more long-term welfare recipients – the most difficult cases – are being employed in the private sector and seven out of 10 welfare recipients are using WOTC to help find private sector jobs. A 2011 study by Peter Cappelli of the Wharton Business School at the University of Pennsylvania found that individuals hired under WOTC go on to become productive employees who are no longer dependent on public assistance.

Further, WOTC works. In 2011, more that 1.1 million workers found jobs through WOTC, at an average cost of approximately $1,300 based on Joint Committee on Taxation data. It is important to note that this figure does not reflect any offsetting savings from lower welfare, disability, and social security payments. The Cappelli study found that WOTC is one of the most successful and cost effective federal employment programs.

WOTC was most recently extended by the *American Taxpayer Relief Act of 2012* retroactive to the beginning of 2012 and through the end of 2013. Consequently, the provision will expire again at the end of this year unless Congress takes action. Allowing this provision to expire again at a time of intransigent unemployment would be a significant setback for job creation. Congress should make WOTC permanent, since it has proven to be an efficient incentive for businesses to provide jobs for workers who might otherwise fall through the cracks. Doing so would further provide taxpayers with predictability and certainty in the tax code.

Retention of the FICA Tax Tip Credit Reimbursement

The FICA Tax Tip Credit Reimbursement, codified in Section 45B of the tax code, is a reimbursement available to food and beverage companies for the employers' portion of FICA taxes on reported tip income above the minimum wage. That reimbursement is, in effect, an intermediary fee for encouraging tip reporting and helping the IRS collect employment and income taxes owed by employees on their tips. Employers who choose to take the Section 45B reimbursement put processes and systems in place to capture tip data including new-hire training, point of sale system prompts, manager reviews of tip reports and continuing employee education. Today's successful tip reporting regime has been developed with the IRS over the last 20 years, and maintaining the FICA Tax Tip Credit Reimbursement is an integral part of current compliance and enforcement strategies

As background, restaurant servers and bartenders are required to report tips to their employers. The employers in turn base income tax withholding and payment of FICA taxes on this information. Employers withhold and deposit employees' FICA taxes on all regular wages and reported tip income. But in addition to paying the employer's share of FICA taxes on regular wages, employers also pay employer FICA taxes on employees' tip income. At the end of the year, in exchange for actively encouraging tip reporting, withholding taxes and transmitting that information to the IRS, food and beverage establishments can claim the Section 45B nonrefundable credit to reimburse the portion of FICA taxes on tip income above the federal minimum wage.

The credit for employer-paid FICA taxes on tips originated with the *Omnibus Budget Reconciliation Act of 1993* (P.L. 101-508). It serves two purposes: it helps close the tax gap, and it ensures that tipped restaurant employees are maximizing their retirement benefits. Former Ways and Means Committee Chairman Bill Archer (R-TX), who was on the Committee when the reimbursement was created, explained that "the FICA tax tip credit is unique from other credits – rather than a subsidy, it is an integrated component of the requirement that employers pay FICA taxes on deemed employee tip income." Section 45B does double duty by encouraging accurate reporting of tips for both FICA tax and income tax purposes and helps to ensure accurate Social Security benefits for tipped workers.

Former Ways and Means Committee Member Barbara Kennelly (D-CT), also on the Committee when the reimbursement was created, said, "with so many seniors dependent on the system, it is critical that low-income workers, such as Food and Beverage workers, fully pay into Social Security during their working years."

Economist Don Bruce, Ph.D., of the University of Tennessee, produced an economic analysis of the FICA Tax Tip Credit Reimbursement in February 2012. He similarly reports that

repealing Section 45B could have significant negative consequences. Dr. Bruce found that if tip reporting fell between 18 and 23 percent following repeal of Section 45B, then repeal would in fact lose revenue for the government.

The Section 45B reimbursement is not just another tax expenditure. It is distinguishable from other credits and deductions because it provides a positive return on investment to the government. It incentivizes complete and accurate tip reporting, which means additional income tax revenue for the Treasury and additional FICA taxes for the Social Security and Medicare trust funds.

Permanence for the Deduction for Charitable Donations of Food Inventory for Small Businesses

Each day, 35 million Americans are at risk of hunger. At the same time, billions of pounds of food are wasted each year. America's restaurants give back to their communities in major ways, the most significant of which is through food donation. According to National Restaurant Association research, 73 percent of restaurants donate food to individuals or charities.

The deduction for charitable donation of food inventory is a critical tool in alleviating hunger. Without the provision, taxpayers get the same tax treatment for throwing out surplus food as they do for giving it to charity. The enhanced deduction instead encourages donating the food to charity, by helping to offset the costs associated with storing and transporting the extra food. Absent the enhanced deduction for the charitable donation of food inventory, these charities would be hard-pressed to meet critical demands, putting our nation's most vulnerable families at risk for hunger.

However, the impact of the deduction could be improved. For nearly 30 years since its inception in 1976, the tax deduction for contributions of food inventory was limited to C corporations. In 2005, the provision was temporarily expanded to include pass-through entities (i.e., Subchapter S corporations, limited liability companies) and has been extended on subsequent occasions; most recently it was part of the *American Taxpayer Relief Act of 2012*. Making permanent the now-temporary component of the deduction would make it more effective, while advancing the objectives of providing taxpayers with simplicity and predictability.

The National Restaurant Association strongly encourages its members to donate more food and has partnered with Food Donation Connection ("FDC") to strengthen this effort. Founded by a former restaurant executive, FDC serves as the liaison between the restaurants interested in donating food and the social service agencies adept at getting that food to people in need. FDC helps restaurants develop and implement programs designed to provide an alternative to discarding surplus food while capitalizing on the economic benefits of those donations through the tax savings. Since 1992, FDC has helped facilitate the donation of over 210 million pounds of food to non-profit, hunger-relief agencies.

We urge the retention of the enhanced deduction for donations of food inventory. We also urge Congress to make permanent the temporary provision allowing unincorporated small businesses the same enhanced deduction for food donations.

Restoring the Business Meal Deduction

Under current law, the business meal and entertainment deduction is limited to only 50 percent of costs incurred. By way of background, business meals previously were fully deductible. In 1986, the deduction was reduced to 80 percent and, in 1993, the deduction was further reduced to its current level of 50 percent.

The business meal deduction should be reformed to better reflect the basic principle that business expenses should be fully deductible. Full deductibility would appropriately bring the business meal deduction in line with other ordinary and necessary business expenses, but even increasing the limitation back to 80 percent would better align the provision with these objectives.

According to National Restaurant Association research, increasing the business meal deduction to 100 percent would increase business meal sales by $14.2 billion and create an additional 352,000 jobs. Increasing the business meal deduction to 80 percent would increase business meal sales by $7.9 billion and create an additional 195,000 jobs. Moreover, restaurants service more than 130 million guests every day and the overall impact to the economy of full deductibility or a return to 80 percent deductibility of business meals would be significant. Each dollar spent dining out generates $2.05 in business to other industries, totaling more than $1.7 trillion in overall economic impact.

More importantly, at a time when the country is getting back on stronger economic footing, this reform measure is particularly critical especially for the small businesses and self-employed individuals that depend so heavily on business meals to conduct business. Small businesses often use restaurants as "conference space" to conduct meetings or close deals. Meals are their best, and sometimes only, marketing tool. Certainly, an increase in the meal and entertainment deduction would have a significant impact on a small business's bottom line.

Conclusion

Thank you for the opportunity to submit this statement on behalf of the National Restaurant Association. Again, we applaud the Committee for its work to date and commitment to make the tax code more certain, fairer, simpler while also encouraging economic growth and job creation. As the Committee moves forward with its deliberations, we would be pleased to serve as a resource.

Figure 2.

Estimated Impact of Extending 15-Year Restaurant Depreciation Provision Through 2013

State	Increase in Spending on Restaurant Improvements & New Construction (in millions)	Total Economic Impact Within the State (in millions)	Total Employment Impact Within the State (total jobs in all industries)
Alabama	$78	$170	1,591
Alaska	$21	$37	263
Arizona	$113	$233	1,913
Arkansas	$53	$104	961
California	$851	$1,953	13,122
Colorado	$130	$293	2,264
Connecticut	$101	$192	1,250
Delaware	$22	$41	269
District of Columbia	$26	$31	42
Florida	$380	$785	7,054
Georgia	$194	$441	3,818
Hawaii	$42	$80	609
Idaho	$40	$71	718
Illinois	$312	$728	4,870
Indiana	$134	$294	2,381
Iowa	$81	$144	1,293
Kansas	$60	$115	900
Kentucky	$75	$161	1,406
Louisiana	$87	$182	1,518
Maine	$42	$82	834
Maryland	$129	$250	1,758
Massachusetts	$193	$382	2,474
Michigan	$224	$482	4,051
Minnesota	$118	$251	1,957
Mississippi	$47	$94	872
Missouri	$127	$275	2,145
Montana	$39	$73	748
Nebraska	$48	$80	723
Nevada	$58	$109	801
New Hampshire	$39	$78	586
New Jersey	$254	$550	3,468
New Mexico	$37	$71	659
New York	$595	$1,075	7,049
North Carolina	$190	$391	3,665
North Dakota	$22	$38	307
Ohio	$254	$584	4,840
Oklahoma	$70	$150	1,424
Oregon	$117	$241	2,018
Pennsylvania	$330	$781	5,728
Rhode Island	$39	$71	539
South Carolina	$98	$214	2,016
South Dakota	$25	$42	416
Tennessee	$109	$246	2,035
Texas	$427	$1,068	8,210
Utah	$48	$112	1,012
Vermont	$21	$39	384
Virginia	$166	$345	2,645
Washington	$187	$408	3,010
West Virginia	$38	$73	627
Wisconsin	$173	$362	3,036
Wyoming	$17	$29	241
United States	$7,081	$23,944	199,830

Source: National Restaurant Association estimates, with economic and employment impact based on BEA multipliers

Note: State impact figures do not sum to the U.S. total, because they only include inputs within each state.

April 11, 2013

The Honorable Sam Graves
Chairman
Committee on Small Business
United States House of Representatives
Washington, DC 20515

The Honorable Nydia Velazquez
Ranking Member
Committee on Small Business
United States House of Representatives
Washington, DC 20515

Re: Hearing on Small Business Tax Reform: Growth Through Simplicity

Dear Chairman Graves and Ranking Member Velazquez:

Please add the support of the National Retail Federation (NRF) to the hearing record for your April 10 hearing on small business tax reform.

NRF believe that the most important aspect of any tax reform measure is its impact on the economy, jobs, and the consumer. The U.S. economy is coming out of the worst recession since the Great Depression, but economists predict that economic growth may continue to be slow, which will also continue to depress consumer spending. Tax reform can provide much needed stimulus to the economy and should be enacted as expeditiously as possible.

We believe that a reform of the income tax, by providing a broad base and low rates, will bring the greatest economic efficiency 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 form of legal entity (e.g. C corporations vs. pass-through entities), how property is owned (e.g. leased stores vs. owned stores), and distribution channel (e.g. brick and mortar sales vs. remote sales).

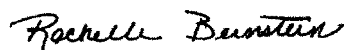
Exchanging so-called "tax expenditures" for lower tax rates will not only result in greater economic efficiency, it will also eliminate some of the major complications in the current Internal Revenue Code. The vast majority of retailers are small businesses. In fact, 96% of all retailers have only one location. The policy of eliminating tax expenditures in exchange for lower tax rates is important for both large and small businesses because it will lead to a more productive employment of capital and more economic growth. Retailers, both small and large, are high effective taxpayers and prefer the simplicity of a tax system that exchanges complex tax expenditures for lower rates, allowing businesses to make economic decisions for their enterprises that are based on the best business result, rather than tax motivations. Because most small business owners report taxes as individuals, generally as S corporations or partnerships, there are some additional considerations to this reform that may not be present in the debate of corporate tax reform.

Liberty Place
325 7th Street NW, Suite 1100
Washington, DC 20004
800.NRF.HOW2 (800.673.4692)
202.783.7971 fax 202.737.2849
www.nrf.com

The NRF commends Chairman Camp for issuing a discussion draft for reforming small business tax rules. The options included in the draft recognize that tax reform must be comprehensive with respect to all businesses, whether C corporations or "pass-throughs." The Chairman's proposed expansion of the cash method of accounting will be particularly helpful to small retailers. Section 179 expensing is also very helpful for small retailers, but the current definition of qualifying expenses puts retailers that own their buildings at a competitive disadvantage vis-à-vis retailers that lease their buildings.[1] Many small retailers own their buildings in order to achieve the best location for their store in the community, or because they want to invest in an asset that will maintain its value for retirement, or because they have inherited a family business that includes the real estate. The NRF believes that tax reform should eliminate provisions that discriminate between taxpayers in the same industry.

The NRF supports income tax reform that will lower tax rates and broaden the tax base. We believe this type of income tax reform will be good for the retail industry and good for the economy as a whole. The NRF urges Congress to pass tax reform legislation this year, and we offer whatever assistance we may provide in meeting this goal. Income tax reform will encourage investment, create jobs and simplify administration of the tax system.

Sincerely,



Vice President, Tax Counsel
Government Relations

[1] The definition of "qualified retail improvement" is narrower than the definition of "qualified leasehold improvement." For retailers that own their buildings, only improvements to space that is "open to the public" is eligible for Section 179. Retailers that lease their buildings can also get Section 179 benefits for improvements to backroom, warehousing, and other non-public space.

National Roofing Contractors Association
Washington, D.C. Office
324 Fourth Street, N.E.
Washington, D.C. 20002
202/546-7584
Fax: 202/546-9289
http://www.nrca.net

April 10, 2013

The Honorable Sam Graves	The Honorable Nydia Velazquez
Chairman	Ranking Member
Committee on Small Business	Committee on Small Business
U.S. House of Representatives	U.S. House of Representatives
Washington, DC 20515	Washington, DC 20515

Dear Chairman Graves and Ranking Member Velazquez:

The National Roofing Contractors Association (NRCA) commends you for holding this hearing entitled "Small Business Tax Reform: Growth Through Simplicity." NRCA supports efforts to reform and simplify the tax code in order to facilitate the ability of entrepreneurs in the roofing industry to grow their businesses and create jobs. Comprehensive reform of the tax code is especially important for the thousands of small businesses that dominate the roofing industry.

Established in 1886, NRCA is one of the nation's oldest trade associations and the voice of professional roofing contractors worldwide. NRCA has approximately 4,000 contractors in all 50 states who are typically small, privately held companies, with the average member employing 45 people and attaining sales of about $4.5 million per year.

Employers need a cleaner, simpler and easily understandable tax code that will allow them to focus more of their time and resources on growing their business. Today the internal revenue code contains almost four million words and, on average, has more than one new provision added to it daily. According to the Office of the Taxpayer Advocate, taxpayers (both individuals and businesses) spend more than 6.1 billion hours annually filing their taxes and roughly nine in ten Americans rely on paid professionals or commercial software to prepare their tax returns.

One of most effective measures that Congress could enact to facilitate greater economic growth in the roofing industry is reform of the depreciation schedule for commercial roofs, which was set at 39 years in 1993. A study by global consulting firm Ducker Worldwide concluded that the average life span of a commercial roof is only 17 years and also that a 20-year depreciation schedule would facilitate the creation of nearly 40,000 new jobs in our industry annually. The current depreciation schedule is an obstacle to economic growth because it provides an incentive for building owners to address failing roofs with piecemeal repairs rather than complete roof retrofits. Additionally, many small businesses must depreciate multiple roofs for tax purposes which creates an unnecessary paperwork burden. Setting the depreciation schedule in line with the life of the asset, as NRCA has supported for many years, is consistent with the goals of tax reform to foster greater investment and encourage economic growth.

NRCA wishes to commend Ways and Means Committee Chairman Dave Camp (R-MI) for recently proposing a tax reform discussion draft that provides a legislative framework that simplifies the tax code, lowers tax rates and modernizes the rules that govern pass-through entities. This will allow businesses to retain more of their earnings to invest in creating jobs and spurring greater levels of economic growth.

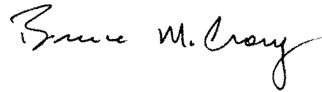
NRCA supports a number of the provisions included in Chairman Camp's discussion draft from H.R. 892, the S-Corporation Modernization Act, bipartisan legislation recently introduced by Reps. Dave Reichert (R-WA) and Ron Kind (D-WI). Many of the rules that govern the day-to-day management of S-Corporations date back more than half a century and are badly in need of updating. This legislation is designed to improve the tax rules governing S corporations to provide entrepreneurs with increased access to much-needed capital. Key provisions include permanently setting the built-in gains tax holding period to five years (down from 10 years); increasing the "Sting Tax" gross receipts threshold from 25 percent to 60 percent on passive investment income; and expanding the ability of S corporations to make charitable donations.

Another key component of the Camp discussion draft that NRCA supports is permanently increasing Section 179 expensing for small businesses to $250,000 and allowing the deduction to be used for qualified real property. NRCA supports this provision which enables businesses to immediately deduct a sizable portion of investments in equipment in the year the investment is made rather than claiming the deduction over a longer depreciation period, thus greatly simplifying tax preparation.

Finally, NRCA believes that comprehensive tax reform that lowers rates for corporations and pass-through entities is the only path forward. If corporate-only reform is enacted, small businesses would be put at a great disadvantage and in fact would see their taxes increase. A recent study conducted by Ernst & Young found that corporate-only reform would increase the income taxes paid by individual owners of flow-through construction businesses by 9 percent on average, or $26 billion annually. NRCA strongly opposes any tax reform legislation that increases taxes on businesses in the roofing industry.

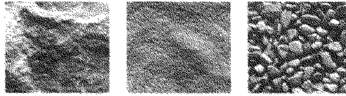
Again, thank you for holding this hearing and considering NRCA's views on tax reform. NRCA looks forward to working with Congress in efforts to reform the tax code for small businesses. If you have questions or need more information, please contact Andrew Felz, NRCA's manager of federal affairs, at 202-400-2590 or afelz@nrca.net.

Sincerely,



Bruce McCrory
Kiker Corp., Mobile, AL
President, NRCA

NATIONAL STONE, SAND & GRAVEL ASSOCIATION



Natural building blocks for quality of life

April 12, 2013

The Honorable Sam Graves
Chairman
House Committee on Small Business
United States House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Graves:

On behalf of the membership of the National Stone, Sand & Gravel Association, thank you for holding the hearing on *Small Business Tax Reform: Growth Through Simplicity*. NSSGA supports minimizing the tax burden on small businesses and working families in order to increase the rate of capital formation, economic growth, and job creation. Our members support pro-growth tax reform legislation that will reduce and simplify taxes by, among other provisions, eliminating the "death tax," reducing taxes on capital gains, and maintaining the percentage depletion allowance for aggregates.

Repeal the Estate Tax

A majority of our members are what would be considered small businesses, and many are family-owned. As such, changes in the federal estate tax fall very heavily on our members. NSSGA supports reduction or elimination of the estate tax that was repealed by the *Economic Growth and Tax Relief Reconciliation Act of 2001,* but returned in 2011. Before the tax returned to its pre-2001 rate of 55 percent and a $1 million per person exemption, President Obama and congressional Republicans crafted a compromise top rate of 35 percent with an exemption of $5 million per person for the years 2011 and 2012. The 2013 "fiscal cliff" deal made reform permanent, but increased the top rate to 40 percent while maintaining the exemption levels.

NSSGA believes the time is ripe to finally repeal a tax that disadvantages small business owners and family businesses that are the engine of economic growth.

Maintain the Percentage Depletion Allowance

Percentage depletion is the capital cost recovery method recognized in the tax code for the aggregates industry and other natural resources industries. It is five percent for sand, gravel, and crushed stone, and varying amounts up to 22 percent for other minerals. Percentage depletion is limited to 50 percent of net income, less exploration costs, and is a preference item for the corporate minimum tax.

1605 KING STREET ■ ALEXANDRIA, VA 22314
703 525 8788 ■ 800 342 1415 ■ FAX 703 525 7782
WWW.NSSGA.ORG

During earlier tax reform debates, in the search for additional revenues, efforts have been made to eliminate the percent depletion deduction for hard rock minerals. Although not the target of these efforts, aggregates producers are concerned that there will be attempts to eliminate the percentage depletion deduction for aggregates.

Sold on a competitive basis, crushed stone, sand, and gravel are low-value commodities that are very sensitive to cost-production factors including percentage depletion, with a penny per ton making a significant difference. Repealing percentage depletion for aggregates would increase the cost of constructing public works and infrastructure by raising mining costs that would be passed on, in higher prices, to the end users of aggregates. Repealing percentage depletion would disrupt the production of needed construction materials and it would unfairly tax western states where mining is more prevalent.

NSSGA urges Congress to resist efforts to repeal the percentage depletion for aggregates.

Provide Capital Gains Tax Relief

Relief from capital gains taxes is imperative and supported by NSSGA members. Taxes on capital gains have significantly increased since the mid-1980s. Reduction in taxes on capital gains would have a positive impact on the economy through increased domestic investment, real income, and revenue for the Treasury.

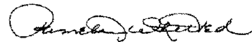
Support for Additional Tax Reforms

NSSGA also supports the continuation of the 50 percent bonus depreciation for capital investment, as passed under the *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010* and extended through 2013 under the *American Taxpayer Relief Act*; the retention of the last-in, first-out (LIFO) method of accounting for inventories, which permits aggregates producers to treat the most recently acquired (or manufactured) goods as having been sold during the year; and the rejection of temporary regulations on capitalization rules on tangible property, which for an asset-intensive industry like the aggregates industry, are overly burdensome and could further slow the industry's recovery.

The complexities of the tax code have placed an enormous burden on small businesses and their employees who are the drivers of economic growth and job creation. NSSGA supports tax reform that would simplify the tax code resulting in lower administrative and compliance costs, and would provide the certainty that allows informed and cost-effective allocation of human and financial resources.

NSSGA welcomes this opportunity to comment on the small business tax reform issues most important to our membership, and supports your efforts to help this Congress craft meaningful and comprehensive tax reform legislation that will undoubtedly spur the American economy.

Sincerely,



Pamela J. Whitted, Senior Vice President,
Legislative & Regulatory Affairs
National Stone, Sand & Gravel Association

April 12, 2013

The Honorable Sam Graves
Chairman
Committee on Small Business
U.S. House of Representatives
Washington, D.C. 20515
Via electronic mail

RE: Comments for the record on small business tax reform.

Dear Chairman Graves:

On behalf of the Small Business & Entrepreneurship Council (SBE Council) and our 100,000 members and supporters nationwide, I am writing to thank you for hosting the April 10 hearing on the benefits of tax reform and simplification for small businesses. Making the tax system less complex and friendlier to entrepreneurs and small businesses is a top priority for SBE Council. We are pleased that SBE Council has been given the opportunity to provide direct input to the tax reform working group on small business. We are very hopeful that this important effort will produce positive outcomes for America's entrepreneurs.

SBE Council is pleased that Ways & Means Chairman Dave Camp took the time to present the small business discussion draft to the Small Business Committee on April 10. That gesture and outreach demonstrates a commitment to America's small business owners, as does the content of the discussion draft itself. Our organization is pleased with specific proposals presented in the draft, but we are encouraging all the working groups to be bold in their reform proposals. Specifically, we are working to advance reform proposals that are pro-growth in nature and ones that will encourage capital formation, investment and increased start-up activity. Given the mobility of capital, our tax system must also be globally competitive – SBE Council continues to make this important point with the various tax reform working groups.

With respect to the small business discussion draft, SBE Council believes that items within the draft align with small business concerns regarding complexity and cost, as well as bringing certainty and stability to the tax system. For example, making

the section 179 expensing provision permanent will spur investment and allow small business owners and entrepreneurs to plan their investments more rationally. In addition, the goal of simplification is also met by expanding the use of the cash accounting method by more small businesses. A unified deduction for startup businesses will be simpler for new entrepreneurs while providing relief. Reordering and simplifying the due dates of tax returns for partners and S corporations will also make tax compliance easier as will the options for reform of the tax rules applicable to these businesses.

As you know, small business owners have been suffering under either a depressed or weak economy for more than five years. There has been an "entrepreneurship recession," if you will, during this same period. Reforming our tax system will help to boost startup activity, and give existing businesses the relief, certainty and incentives they need to survive, compete and grow.

Certainly, lower tax rates need to be a central feature of tax reform. The proposals to bring the top personal and corporate income tax rates down to 25 percent would be a massive boost to all of our businesses. Lowering rates is also a competitiveness issue as personal tax rates in the U.S. (federal and state combined) stand at 47 percent vs. the global average of 32 percent. For corporate tax rates, the U.S. stands at 40 percent (federal and state combines) vs. the global average of 24 percent. It is absolutely essential to the economy's growth, and job creation, that these rates be lowered.

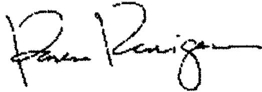
To encourage capital formation and investment, the U.S. ideally would eliminate the individual capital gain tax. The next best alternative would be to reduce the rate and index for inflation. We believe the President's proposal to zero out capital gains for startups, while worthy, needs to be expanded beyond "qualified" businesses (such as to S Corps, LLCs, etc.). Once investment crowdfunding rules are established, more potential investors would benefit from the lower rate, and more businesses from the investments that are made.

While SBE Council supports eliminating "loopholes and deductions" that have made their way into the tax code, we are warning members of Congress about efforts to paint ordinary business expense deductions as loopholes where they are not. One example of this is interest on debt. A recent study by two economists, one from DePaul and one from Brock University, reported that more than 75 percent of startups use some form of debt financing. Obviously eliminating this legitimate business expense would harm startup activity and access to capital.

The draft discussion on small business tax reform certainly is a good start. Some questions remain on other issues of importance to small businesses, like the death tax and what taxes may have to be raised to support tax reform (SBE Council favors revenue neutral tax reform), but we are heartened by progress to date.

Chairman Graves, thank you for your leadership and support of America's entrepreneurs. Please do not hesitate to call upon the SBE Council if we can be of further help in advancing policies and initiatives that help small businesses grow and succeed.

Sincerely,



Karen Kerrigan
President & CEO

301 Maple Avenue West • Suite 690 • Vienna, VA 22180 • 703-242-5840 • www.sbecouncil.org

Protecting small business, promoting entrepreneurship

April 18, 2013

Chairman Sam Graves
House Committee on Small Business
U.S. House of Representatives
Washington, DC 20515

Ranking Member Nydia Velazquez
House Committee on Small Business
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Graves and Ranking Member Velazquez:

On behalf of the Specialty Equipment Market Association (SEMA), I welcome the opportunity to comment on the recent efforts to address comprehensive tax reform. SEMA is pleased that the House Ways and Means Committee has taken initial steps to simplify the tax code, close loopholes, and lower small business tax rates and that the House Small Business Committee is supporting those efforts.

SEMA represents the $30 billion specialty automotive industry comprised of 6,500 member companies nationwide. The industry provides appearance, performance, comfort, convenience and technology products for passenger and recreational motor vehicles. An estimated 92% of SEMA members are considered small businesses.

SEMA is particularly encouraged by the efforts to make Section 179 expensing permanent, which will allow small businesses to immediately deduct investments in new equipment up to $250,000. As with many provisions of the tax code, companies have not always known in advance how the Code would be applied in future years or, in some cases, have been forced to rely on retroactive treatment. Making the Section 179 provision permanent is crucial for helping remove uncertainly as companies contemplate investment decisions.

Prior to 2008, businesses were allowed to expense up to $125,000 on qualifying equipment. Responding to the recession, lawmakers expanded the provision to $500,000 to give businesses of all sizes an incentive to invest in their companies. Businesses responded accordingly, helping support the U.S. economy through the sales of new equipment. SEMA believes $250,000 is an appropriate level for the Section 179 deduction, allowing companies of all sizes a chance to invest in their future, especially as they grow and expand. SEMA would further recommend that the deduction be indexed for future inflation.

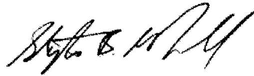
SEMA also supports efforts to replace small business tax-accounting rules with a uniform rule allowing for a more streamlined and efficient method of accounting. Increasing the current gross receipts test from $5 million to $10 million and permitting those companies to use a cash accounting method helps achieve that goal.

Many SEMA member companies were started by automotive enthusiasts applying their industry expertise to create new, innovative automotive products. The current comprehensive tax reform discussion draft will assist these types of businesses by establishing a single deduction for start-up and organizational expenses. Increasing the threshold for start-up expenses from $5,000 to $10,000 will also provide necessary tools for very small companies to gain a foothold toward future prosperity.

These initial steps toward a final comprehensive tax reform legislative package are promising and indicate a strong bipartisan effort to enact meaningful changes for small businesses. SEMA looks forward to working with members of both the House Small Business Committee and the House Ways and Means Committee to provide small businesses with the tools they need to continue driving America's economic growth.

Thank you for the opportunity to comment on this timely and important legislation. If you have any questions, or require additional information please feel free to contact me by phone or by e-mail at stevem@sema.org.

Sincerely,



Stephen B. McDonald
Vice President, Government Affairs

TechAmerica.org

TechAmerica
601 Pennsylvania Avenue, NW
Suite 600, North Building
Washington, DC 20004
P 202.682.9110

April 18, 2013

The Honorable Vern Buchanan
Chairman, Working Group on Small Business and Pass-Throughs
House Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

The Honorable Allyson Schwartz
Vice Chairman, Working Group on Small Business and Pass-Throughs
House Committee on Ways and Means
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Washington, DC 20515

Dear Chairman Buchanan and Vice-Chairwoman Schwartz:

TechAmerica[1] is pleased to provide comments on Chairman Camp's discussion draft released on March 12, 2013, which draws upon legislative concepts to create a simpler and fair tax code for small businesses that are supported by both Republican and Democratic on the House Ways and Means Committee. In the past, TechAmerica has underscored the importance of fundamental tax reform and the need to create a globally competitive system that fosters capital investment and job growth. TechAmerica represents companies of all sizes and applauds the Committee's common sense approach to modernize the tax code and reduce the burden it imposes on small businesses.

One of the greatest challenges facing these businesses is gaining access to enough capital to get off the ground in the first few years. The expense and time required to comply with government regulations has long been an obstacle towards achieving this goal. Relieving fast-growing, entrepreneurial start-up businesses from rigid tax code compliance is one of the best ways Congress can help encourage early-stage growth. This would greatly benefit the technology industry in particular; no other industry produces or relies on startups more than high tech.

TechAmerica supports provisions in the discussion draft that reform and simplify a number of tax rules affecting small businesses and their employees. Notable examples include increased section 179 expensing, simplification of cash accounting methods for businesses with gross receipts of $10 million or less, and unified deductions for start-up and organizational costs. These changes would help eliminate bureaucratic red tape and ensure American small businesses maintain global leadership in research and innovation. Furthermore, TechAmerica supports lowering the tax rate at the individual level which would make for a promising initiative to help such entities grow and prosper.

The discussion draft also addresses partnership and S corporation tax reform options. As the largest high-tech trade association, TechAmerica represents a wide array of companies including C corporations, S corporations, and partnerships. We believe that any corporate tax reform legislation should focus on

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[1] TechAmerica is the leading voice for the U.S. technology industry – the driving force behind productivity growth and job creation in the United States and the foundation of the global innovation economy. Representing premiere technology companies of all sizes, we are the industry's only trade association dedicated to advocating for the ICT sector before decision makers at the state, federal and international levels of government. With offices in Washington, D.C., Silicon Valley, Brussels and Beijing, as well as regional offices around the U.S., we deliver our members top-tier business intelligence and networking opportunities on a global scale. We are committed to expanding market opportunities and driving the competitiveness of the U.S. technology industry around the world. *Learn more about TechAmerica at www.techamerica.org.*

TechAmerica.org

TechAmerica
601 Pennsylvania Avenue, NW
Suite 600, North Building
Washington, DC 20004
P 202.682.9110

streamlining and simplifying the tax code while maintaining a level playing-field for all companies regardless of size.

In short, TechAmerica supports measures in the discussion draft aiming to spur innovation and job creation by easing the weight of tax code compliance on small businesses. TechAmerica's member companies have substantial operations in the U.S. and countries all over the world, so these firms understand best the tax challenges facing the U.S. technology sector globally in an increasingly competitive landscape and factors for success. Please feel free to consider the experience and expertise of our members as an ongoing resource available to your committee in your work on tax reform.

Thank you for considering TechAmerica's views on this important subject. We look forward to working with the Working Group and with the Committee to address these issues as the legislative process moves forward.

Sincerely,

Kevin Richards
Senior Vice President, Federal Government Affairs