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FULL COMMITTEE HEARING ON TAX INITIATIVES THAT PROMOTE SMALL BUSINESS GROWTH

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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FULL COMMITTEE HEARING ON TAX INITIATIVES THAT PROMOTE SMALL BUSINESS GROWTH

Wednesday, May 5, 2010

U.S. 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. Nydia Velázquez [chairwoman of the Committee] presiding.

Present: Representatives Velázquez, Moore, Dahlkemper, Clarke, Ellsworth, Bright, Graves, Thompson, and Coffman.

Chairwoman VELÁZQUEZ. This hearing is now called to order. In recent weeks, our economy has shown promising signs of recovery. Gross domestic product grew at 3.2 percent during the first quarter of this year, marking the third straight quarter of economic growth.

Consumer spending is on the rebound. March saw the sixth straight month with a rise in individual spending. Most importantly, the U.S. economy added 162,000 jobs in March, the largest increase in nearly 3 years.

The American Recovery and Reinvestment Act fueled much of this progress. Not only did that measure boost infrastructure spending. It provided billions of dollars in tax cuts, including $15 billion in targeted tax relief for small firms.

Today's hearing would allow the Committee to analyze how tax policies can sustain and further accelerate our economic recovery going forward.

Since the Recovery Act's passage, we have built on its momentum, extending many provisions that would have otherwise expired at the end of 2009. More recently, the Hire Act was enacted, providing a tax credit for small businesses that bring on new employees. It also extended a credit for entrepreneurs purchasing business equipment, helping firms to expand and stimulating demand for everything from trucks to computers to machinery.

Our witnesses today will be able to give us an assessment of how well these initiatives are working and how to improve them. In every previous economic recovery, small firms have led the way, creating more jobs and generating them more quickly than their big business counterparts.

Following the recession of the early 1990s, small firms created 3.8 million jobs. After the recession of 2001, micro businesses alone generated one million jobs. Entrepreneurs will be just as important

to bringing our nation out of today's downturn but only if they have the right tools.

While showing promising signs, today's recovery is in its earliest, most fragile stages. As our recovery gains traction, it is vital that our tax policy promotes small business job growth and does not hinder it. In that vein, it is my hope that today's hearing will help improve existing tax programs while generating new ideas for targeted tax relief.

With that, I would like to take this opportunity to thank all of the witnesses in advance. And I now yield to Ranking Member Graves for his opening statement.

Mr. GRAVES. Thank you, Madam Chair, for calling this hearing on the critical topic of tax incentives that promote small business growth. I would also like to thank our witnesses. Some of you have come from a ways away and obviously taken time away from your company to be here with us today. So thank you very, very much.

The economy is still struggling. And outlook is still uncertain. We have got foreclosures, credit card defaults, and bankruptcies that still remain high. And unemployment is still hovering around 10 percent. For businesses and especially small ones, capital markets remain tight. Few are expected to hire or expand. Companies remain skeptical about a lasting economic recovery.

Small businesses are reeling from the news. And under the new health care law, they are going to be forced to provide health insurance or pay a penalty. And that is in addition to the myriad of new regulations and reporting requirements.

Just one example, in section 9006 of the new law, it requires businesses to submit a form 1099 for every business-to-business transaction at $600 or more of property of services.

Small businesses already bear a heavy burden of paperwork compliance. And this is just another example of forcing small business owners to take time away from the business to comply with an unnecessary mandate.

Of course, small business owners could choose to outsource the paperwork to an accounting firm, but either way, the entrepreneur loses scarce resources that could be spent gaining more customers or producing more product.

Higher taxes, more mandates, new regulations, and piles of paperwork do not foster an environment that is conductive for creating jobs. Taxes are a constant concern for small businesses. In this economic climate, every expense is an added burden. Small businesses pay more per employee to comply with the tax code and often can't afford the experts to help navigate through it.

Entrepreneurs depend on tax incentives to offset some of the costs of innovation and expansion. While I support temporary tax provisions or entendres because I know they are critical to small businesses, their temporary nature causes uncertainty.

Not knowing whether these tax provisions are going to be renewed makes it very difficult for small businesses to plan for future growth. And I also believe we must make permanent the 2001 and 2003 tax provisions, which lowered marginal rates. And that is why I have introduced legislation to do just that.

Finally, I want to say a word about the estate tax. In my support for complete repeal, if Congress does nothing, the top marginal rate

of 55 percent and an exemption of just a million dollars is going to take effect in 2011.

Small businesses and farms are often operated by families who transferred from one generation to the next. And to pay the estate tax, their heirs could be forced to sell the very land or equipment that is needed to operate that family business. As you have heard me say before, death should not be a taxable event. We must kill the death tax.

Again, thank you, Madam Chair, for holding this hearing on the vital subject of taxes. I look forward to that testimony.

Chairwoman VELÁZQUEZ. Thank you.

And now it is my pleasure to welcome Mr. Dave Koenig. He is the Director of Tax and Profitability for the National Restaurant Association. Mr. Koenig has over two decades of experience in the tax and regulatory areas. The National Restaurant Association, founded in 1919, represents more than 380,000 restaurants and suppliers. Welcome. And you have five minutes.

Mr. KOENIG. Thank you.

STATEMENT OF DAVE KOENIG, DIRECTOR, TAX AND PROFITABILITY, NATIONAL RESTAURANT ASSOCIATION

Mr. KOENIG. Chairwoman Velázquez, Ranking Member Graves, members of the House Committee on Small Business, I appreciate the opportunity to testify before you today on behalf of the National Restaurant Association.

My name is Dave Koenig, Director of Tax and Profitability at the Restaurant Association. I am here today to ask Congress to make permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements. In addition, I ask that Congress increase the business meal deduction from its current level of 50 percent to 80 percent to provide additional stimulus to the economy.

The restaurant industry plays a significant role in this nation's economy. There are 945,000 restaurant and food service outlets in this country. Seven out of ten restaurants are single-unit operators, which means the restaurant industry is an industry of small businesses.

Most eating and drinking establishments employ 50 or fewer employees. Restaurants also serve as the conference rooms for many of the self-employed and other small businesses.

This year the restaurant industry is estimated to generate $580 billion in sales, with an overall economic impact of $1.5 trillion. Every dollar spent dining out generates $2.34 in business for other industries.

The 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements expired at the end of 2009 and must be retroactively extended through the end of 2010 and, in fact, should be made permanent. Bipartisan legislation, H.R. 4306, introduced in December 2009 by Representatives Kendrick Meek and Pat Tiberi would make the 15-year depreciation schedule permanent.

The 15-year depreciation schedule has made significant capital available for restaurant owners to make capital expenditures with

the tax savings. These capital expenditures translate into jobs in the rest of the economy.

In addition, a faster, more accurate depreciation schedule has a direct impact on a restaurant's bottom line. The shortened depreciation schedule provides restaurateurs additional cash flow to reinvest in their businesses, allowing them to expand restaurant jobs and contribute to the community.

Even during these difficult economic times, restaurateurs are planning capital expenditures to improve or expand their businesses. According to the National Restaurant Association's most recent tracking survey, last month, 47 percent of restaurant operators plan to make a capital expenditure for equipment, expansion or remodeling in the next 6 months. The ability to plan for these expenditures and know what the tax treatment will be in subsequent years, particularly during these tough times, is important to those making such decisions right now.

This provision is an important driver of economic stimulus. Making the depreciation schedule for restaurant improvements and new construction permanent will fuel economic activity and create jobs.

It is important to note that 15 years, rather than the current law, 39 years, is also a much more accurate time frame for depreciating or writing off restaurant buildings. With 133 million Americans patronizing restaurants every day, restaurant building structures experience a daily human assault, unlike that borne by any other type of retail building. In fact, our research shows that most restaurants remodel and update their building structures every six to eight years.

The other issue I would like to talk about in my oral statement is the need to increase the business meal deduction to stimulate the economy. We strongly urges Congress to provide economic stimulus by increasing the deduction from 50 to 80 percent for spending on business meals and entertainment.

For many small companies, the ability to conduct business over a meal is their only means of advertising and marketing their business. While officially the recession may be ending, the restaurant industry is still feeling the effects of decreased consumer spending and increased unemployment. Increasing the business meal deduction to its previous level would encourage consumers to dine out and would also benefit small businesses.

This Committee has been a long-time supporter of increasing the business meal and entertainment deduction as a means of providing a boost to the economy and tax relief for a legitimate business deduction incurred by our nation's small businesses.

Last Congress this Committee included a provision to increase the deduction from 50 to 80 percent in the Small Business Tax Modernization and Stimulus Act of 2008.

In closing, I greatly appreciate the opportunity to testify on behalf of the restaurant industry before you today. And I am happy to answer any question that you may have later on. Thank you very much.

[The statement of Mr. Koenig is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Koenig.

Our next witness is Mr. Hugh Joyce. He is the owner of James River Air Conditioning located in Richmond, Virginia. The company was founded in 1967 and now has over 150 employees. Mr. Joyce is testifying on behalf of Air Conditioning Contractors Association, ACCA, representing over 4,00 air conditioning contractors.

Welcome.

STATEMENT OF STATEMENT OF HUGH JOYCE, JAMES RIVER AIR CONDITIONING, ON BEHALF OF AIR CONDITIONING CONTRACTORS ASSOCIATION

Mr. JOYCE. Good afternoon, Chairwoman Velázquez, Ranking Member Graves, and members of the Small Business Committee. Thank you for the opportunity to provide testimony on behalf of small business service contractors that make up the heating, ventilation, air conditioning, and refrigeration industry.

My name is Hugh Joyce. I am the owner of James River Air Conditioning, a family business that offers commercial, residential heating, cooling, plumbing, and electrical services started by my dad in 1967.

I come before you this afternoon as a former Board Member and Member of Air Conditioning Contractors of America. Every day, more than 4,000 ACCA small business contractor members across the nation help homeowners and small businesses and building managers realize the comfort, convenience, and cost benefits of energy-efficient HVAC equipment.

My comments this afternoon summarize my written submitted testimony and focus on energy conservation tax incentives and how they benefit not only residential homeowners and commercial building owners but also the small businesses of the HVACR industries that serve them.

Financial incentives, such as tax credits, tax deductions, and accelerated depreciation, are a powerful way to encourage homeowners and building owners to reach for and obtain higher efficiency HVAC equipment. Financial incentives, like section 25C, the homeowners tax credit, help soften the initial cost of installation and shorten the payback period.

The residential tax credits in the stimulus bill have been crucial in driving investment. They have incentivized homeowners to retrofit their homes with higher-efficiency HVAC appliances, saving energy, and creating jobs, particularly in my business.

In response to a survey conducted in preparation for my testimony today, 75 percent of ACCA contractors have seen such an increase in the sale of qualifying higher-efficiency equipment.

Sugar, in this case tax credits, is very effective with consumers and businesses. It gets them to take action and helps them overcome inertia, particularly in the recessionary time. It is an excellent catalyst for investment. Financial incentives to install energy conservation measures are a quadruple bonus. They save consumers and small businesses money. They create jobs. They result in less greenhouse gas emissions. And they help the environment.

Our company helps consumers aggregate credit programs and assists them in finding what they qualify for. And, in fact, right now our firm is reconstructing 2 1940s homes, deploying every practical energy durability, sustainable strategy that we are aware of, in-

cluding things like rainwater recovery, high-efficiency HVAC, solar voltaic panels, super insulation, et cetera.

These homes will serve initially as model idea homes so our clients can see, feel, touch, and experience near net zero living. And since over 50 percent of American homes were built prior to efficiency standards, there is a huge opportunity to reduce energy consumption and increase sustainability with retrofit programs and incentives.

The gains as a result of the tax code changes in the stimulus bill could come to a halt at the end of this year. ACCA urges Congress to extend these important incentives. ACCA also encourages a robust rebate program in Home Star to complement the 25C tax credit incentives.

There is also no doubt tax credits in the stimulus bill have made high-efficiency HVAC equipment more affordable for homeowners. However, the stimulus lacked a companion incentive for commercial and small business building owners.

We expect the commercial market to be sluggish for some time. And incentives to upgrade and improve can make significant impact quickly. Just look at my state's solar and wind tax credit program, which sold out in hours. There is an appetite for these types of investment assistance.

Additionally, I encourage Congress to reinstate the 50 percent bonus depreciation allowance that expired at the end of 2009, which could also be used for HVAC equipment.

There is a significant amount of deferred maintenance of this type of work that will drive growth while the new construction market sorts itself out over the next two to five years, which is how much time we think it is going to take.

Let me finish by saying fear is crippling American business managers and owners, fear of the unknown and what will come up next. The people I speak with on a day-to-day basis are afraid to do anything right now because they are concerned with the impact of limited credit, new taxes, new rules, health care, and other regulations. We just don't know what will happen next.

We feel we have few advocates other than this Committee. You can help us by sending the right signals and reduce that fear for us as business people. And I can assure you we will work hard to create jobs.

[The statement of Mr. Joyce is included in the appendix.]

Chairwoman VELÁZQUEZ. We have done that in the past. And we will do it again.

Mr. JOYCE. Thank you.

Chairwoman VELÁZQUEZ. Thank you.

Our next witness, Mr. Chad Collins, is the co-owner of Bone Dry Roofing Company in Athens, Georgia. Bone Dry Roofing Company is a full-service residential and commercial roofing contractor. Mr. Collins is also a Director in the National Roofing Contractors Association. NRCA is a nonprofit association that represents all segments of the roofing industry. Welcome.

Mr. COLLINS. Thank you.

STATEMENT OF CHAD COLLINS, BONE DRY ROOFING COMPANY; AND DIRECTOR, NATIONAL ROOFING CONTRACTORS ASSOCIATION

Mr. COLLINS. Madam Chair, distinguished members of the Committee, I would like to thank you for the opportunity to testify on behalf of the National Roofing Contractors Association. I am Chad Collins, President of Bone Dry Roofing. And we have offices in Augusta and Athens, Georgia.

Established in 1886, NRCA is one of the nation's oldest trade associations and the voice of professional roofing contractors worldwide. NRCA has roughly 4,000 members from all 50 states and 54 countries. And our members are typically small businesses.

Unemployment in the construction industry is an alarming 24.9 percent according to recent government statistics. While it was recently reported that the economy grew at an annual rate of 3.2 percent during the first quarter, the data also show that both commercial and residential construction continue to struggle. Clearly the construction industry is one of the hardest hit sectors of the economy.

NRCA urges Congress to take immediate action on targeted policy measures that will spur job growth. We strongly support the Green Roofing Energy Efficiency Tax Act and Small Business Tax Relief and Job Growth Act and believe that the passage of these initiatives will help create jobs in the construction industry, particularly among small businesses.

The roofing industry is uniquely positioned to play an important role in creating high-quality jobs. One of the ways that this can be done is by enhancing the energy efficiency of our nation's buildings.

The Green Roofing Energy Efficiency Tax Act will immediately create an estimated 40,000 new jobs within our industry while also helping to conserve energy and reduce carbon emissions. GREETA also will provide savings to small businesses of all types through a simpler and more equitable system of taxation and lower energy costs.

Passage of GREETA is necessary because between 1981 and 1993, the depreciation schedule for nonresidential property was increased from 15 years to 39 years. However, the current 39-year depreciation schedule is not a realistic measure of the average life span of a commercial roof, which we estimate to be approximately 17 years.

The large disparity between the 39-year depreciation schedule and the average life span of a commercial roof serves as a major incentive for building owners to delay the replacement of failing roofs as long as possible.

An owner who replaces a roof before 39 years have elapsed must continue to depreciate that roof for tax purposes, even though it no longer exists. This incentive to delay roof replacement is slowing the adoption of more advanced energy-efficient and environmentally beneficial roofs in today's marketplace.

GREETA will rectify this situation by reducing the depreciation schedule from 39 to 20 years for roofs that meet a benchmark energy efficiency standard.

Given GREETA's unique combination of job creation and environmental benefits, this legislation enjoys strong support among

both business groups and organized labor. NRCA is also working with our union and industry partners on a targeted version of GREETA that is designed to maximize job creation and energy efficiency in commercial buildings in the short term. Under this targeted proposal, 20-year depreciation would be made available to building owners for energy-efficient roofs only in 2010 and '11 and would adopt the more stringent energy efficiency standards contained in the Energy-Efficient Commercial Roofs Act of 2009.

I want to emphasize that GREETA will create jobs, not through a special tax incentive but by the removal of an obstacle in the tax code which restricts economic growth and impedes the movement towards green buildings that can help us achieve important environmental policy objectives.

NRCA wishes to again thank Chairwoman Velázquez and Representative Moore for your continued support for GREETA. And we urge other members of the Committee to sponsor GREETA as well.

Like other small businesses, many NRCA members have experienced great difficulty in obtaining access to credit in the current economic environment. The scarcity of credit is a key factor in preventing entrepreneurs from expanding businesses and creating jobs.

NRCA wants to commend Chairwoman Velázquez for introducing the Small Business Tax Relief and Job Growth Act, which will help create jobs by providing tax relief targeted at helping entrepreneurs start and grow businesses.

This legislation will increase the tax deduction for business start-up expenditures; will allow businesses to expense structural improvements to buildings, including roofs; and will reduce the capital gains tax rate of small corporations from 35 to 15 percent. NRCA believes these target measures will significantly increase the capital that entrepreneurs need to grow their businesses and create jobs.

To conclude, NRCA urges Congress to address the alarming 25 percent unemployment rate in the construction industry by approving the Green Roofing Energy Efficiency Tax Act and the Small Business Tax Relief and Job Growth Act.

Thank you for your time, and I will be glad to answer any questions.

[The statement of Mr. Collins is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Collins.

Our next witness is Mr. Christopher J. Green. He is President of AGO Studios in Avon, Colorado. AGO Studios is an architectural firm with commercial, hospitality, and residential clients.

Mr. Green is testifying on behalf of the American Institute of Architects. AIA is the leading professional membership association for licensed architects, emerging professionals, and allied partners. Welcome.

Mr. GREEN. Thank you.

STATEMENT OF CHRISTOPHER J. GREEN, AIA, LEED AP, AGO STUDIOS, INC., ON BEHALF OF THE AMERICAN INSTITUTE OF ARCHITECTS

Mr. GREEN. Chairwoman Velázquez, Ranking Member Graves, and members of the Committee, I am Christopher J. Green, AIA, President of AGO Studios, a two-person architectural firm based in Avon, Colorado. I want to thank you for giving me the opportunity to testify today on behalf of my firm and the American Institute of Architects.

The written testimony I have provided you describes in detail the economic challenges facing our profession and proposals to help bring about the economic recovery, but today I would like to use my time to talk about what this crisis feels like in my community and in communities around the country.

We, like everyone else, see the stock market moving up and down and hearing the analysis about the positive signs of the economy, but what we see on Wall Street is not what we are seeing on Main Street with regard to the architects.

First of all, the architects in our organization are, by and large, small business people. And, in fact, 95 percent of those architecture firms employ 50 or fewer people. They are truly the engine that drives the design and construction industry.

Today my industry and colleagues are suffering. Our unemployment rate is 25 percent. That is one of four people is looking for work. That is only counting those who have applied for unemployment insurance.

Many of my colleagues report being underemployed or working without pay for more than a year. And many of those small business owners are not able to get unemployment because they own their firms and, therefore, are not able to be seen in the numbers that we see at the federal level.

It is a huge burden to bear for the workers who have families to feed, mortgages, and tuition bills to pay. At my firm, billings are down significantly from a year ago. Construction starts are few, primarily because the clients I work with are either unable to get the necessary credit to help finance new construction or the remodels that they are contemplating, and they are facing falling property values that are skewed by comparables to short sales or foreclosures that are unnecessarily offsetting the real value of their property.

And in a number of instances, municipalities have cut back so heavily on budgets, personnel, and services that capital projects are not being considered unless absolutely necessary. And in some cases, those are the life blood of some of the firms that do work in our area.

These problems are not unique to Colorado. They are being repeated in virtually every community around the country. And while there are glimmers of hope in the economic figures, I am here to tell you that for our industry, the light at the end of the tunnel is still a distant flicker. Our data shows that we are still at least a year away from having a healthy business environment in the design and construction industry.

A colleague recently came back from a conference with the Associated General Contractors, who indicated that some of the large

firms that do large construction work have a nine-month backlog at best. Our industry provides the work that they use, and it takes 9 or 18 months to get stuff off the drawing boards for these guys to build.

With that in mind, there are a number of tax-related policy incentives that Congress should take and ones Congress should avoid in order to help small business get on their feet.

First, Congress needs to extend and expand clean energy tax incentives. That is why the AIA with a broad coalition of environmental, business, real estate, design and construction groups strongly supports H.R. 4226, the Expanding Building Efficiency Incentives Act of 2009. In particular, the AIA has long backed increasing the energy efficient commercial buildings tax deduction from its current $1.80 per square foot to $3 per square foot.

Because the provision allows for the deduction to be assigned to the designer in the case of a public building, many architects have been able to take advantage of it to lower their tax burden.

In fact, one accounting firm has reported it has secured almost half a billion dollars in tax deductions for firms in the last year alone, and this with nearly half going to firms with 50 or fewer employees. This means greener buildings, lower energy costs, and money back in the pockets of small design firms.

Second, Congress needs to expand tax incentives for small businesses. I am very pleased that Chairman Velázquez has introduced H.R. 4841, the Small Business Tax Relief and Job Growth Act of 2010, which would help small businesses gain access to capital and create jobs.

And, third, Congress needs to oppose tax increases on small businesses. It is my understanding there is a proposal being floated in the Ways and Means Committee to significantly increase the payroll taxes paid by S corporation shareholders. This proposal would hurt small firms, like mine, who are struggling to get back on their feet.

In conclusion, I would like to thank Chairwoman Velázquez, Ranking Member Graves, and the members of this Committee for giving me the opportunity to testify before you today. And I will be happy to answer any questions you may have.

[The statement of Mr. Green is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you.

The Chair recognizes Mr. Graves for the purpose of introducing our next witness.

Mr. GRAVES. Thank you, Madam Chair.

Madam Chair, I am pleased to introduce Curtis Dubay, who is a Senior Policy Analyst for the Heritage Foundation, where he specializes in tax issues.

Before coming to Heritage, Mr. Dubay was a Senior Associate with PricewaterhouseCoopers, previously has served as Senior Economist with the Tax Foundation, and has done research on a wide range of tax issues, including income tax, sales tax, capital gains dividends, and corporate tax.

Welcome to the Committee.

STATEMENT OF CURTIS DUBAY, SENIOR POLICY ANALYST, TAX POLICY, THE HERITAGE FOUNDATION

Mr. DUBAY. Madam Chairwoman, Ranking Member Graves, members of the Committee, thank you for the opportunity to testify on what can be done through federal tax policy to help small businesses.

My name is Curtis Dubay. I am a tax economist at The Heritage Foundation, a non-profit research organization based in Washington, D.C. with over 650,000 members nationwide and growing rapidly.

The views I express in this testimony are my own and should not be construed as representing any official position of the Heritage Foundation.

Many small businesses are struggling to survive as economic recovery remains precarious. There is much the federal government can do to help them, mostly by allowing the recovery to continue without the threat of punitive new taxes and burdensome new regulations. Eliminate these threats, and small businesses will then thrive as the recovery quickens its pace.

Unfortunately, Congress is threatening to do the opposite in four ways. The first threat is a scheduled increase of income tax rates. On January 1st, 2011, the top two income tax rates will rise from 33 percent and 35 percent to 36 and 39.6 percent. According to the Treasury Department, the 8 percent of small businesses that pay the highest 2 tax rates earn 72 percent of all small business income and already pay 82 percent of all income taxes paid by small businesses.

Higher tax rates on these most productive small businesses would drain the businesses of cash flow, the lifeblood of any business, and would diminish the incentives to grow and add new workers.

Instead of raising these rates, at the very least, Congress should drop its plan to increase top tax rates on small businesses and make permanent the current-law tax rates for all taxpayers. This would be the best stimulus for the economy to date.

The second threat is the impending increase of taxes on capital. Under current law, the tax rate on capital gains will increase to 20 percent. And that on dividends will increase to 39.6 percent on January 1, 2011.

Congress should at the very least hold these rates at 15 percent and make permanent President Obama's sensible plan to provide immediate small business expensing of all capital purchases.

The third threat is the planned increase of the death tax. The death tax returns to life in full force on January 1st, 2011. Despite the common misconception that the death tax impacts only wealthy estates, economists now generally agree that the death tax is actually a tax on capital because of its impact on businesses and workers.

The death tax is a drag on America's small businesses, destroys jobs, and lowers wages while raising little revenue. As such, Congress should kill the death tax once and for all to remove an unfair burden from the backs of American small businesses and their workers.

The fourth threat is the burden of new regulation. A little noticed provision added to the new health care law will harass small businesses with new paperwork. Section 9006 of the new law requires businesses to issue 1099s whenever they do more than $600 of business with another entity.

Small businesses will now have to issue reams and reams of new forms to the IRS. While large businesses can absorb the cost of this new bureaucracy with their large legal and accounting teams, the new requirements will inundate small businesses with an avalanche of paperwork. The paperwork burden will force small businesses to redirect scarce resources from productive activities that could grow the business, add jobs, and pay higher wages to complying with the onerous new reporting requirements.

Now, many in Congress would prefer to offer targeted tax credits to specific small businesses, instead of keeping income tax rates and taxes on capital low for all small businesses. The targeted tax cuts are no substitute. Of course, the businesses that receive the targeted tax cuts will benefit, but Congress should not be the arbiter of which businesses succeed and which do not.

Its track record of making such choices is far from exemplary. And further efforts to manipulate the market based on the whims of the moment could actually prevent breakthroughs that would benefit the economy and the United States.

Thank you. And I look forward to your questions.

[The statement of Mr. Dubay is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you.

I would like to address my first question, if I may, to Mr. Koenig. A true economic recovery is going to rely on improving consumer confidence and overall spending. Recent reports indicate spending is on the rise. Can you comment, please, on where your industries stand today, as opposed to 12 or 18 months ago?

Mr. KOENIG. Certainly, Chairwoman Velázquez. The restaurant industry was certainly not immune from the economic troubles of the last couple of years. We have had well-documented in the public media stories about demand being way down because of consumer spending and unemployment. Recently—and we do regular surveys—we see an up tick. Anecdotally speaking, we see an up tick in overall business in the industry.

Not to say that conditions are ideal, but I think it is safe to say that from the restaurant industry's standpoint, we are cautiously optimistic that things are on the up turn, at least with our business.

Chairwoman VELÁZQUEZ. I have noticed it in my district.

Mr. KOENIG. Glad to hear it.

Chairwoman VELÁZQUEZ. You know, I didn't have to make reservations two, three months ago.

[Laughter.]

Chairwoman VELÁZQUEZ. Mr. Collins, can you explain how outdated depreciation schedules for commercial roofs affect economic activity within your industry? And do you find that these businesses are choosing to repair older, inefficient roofs because they do not have the necessary incentive to do so?

Mr. COLLINS. Yes, ma'am, absolutely. And we see it time and time again, regardless of reason, whether it is a facility that is being held for an investment and going to be turned or whatever the reason, the current depreciation schedule has created a disincentive for the owner to be proactive in addressing the issues. And it is literally as simple as that.

Activity like GREETA that would provide incentive would immediately create results. I mean, there is no doubt about that at all.

Chairwoman VELÁZQUEZ. And how would decreasing the recovery period encourage more businesses to upgrade their infrastructure?

Mr. COLLINS. Well, it would encourage the activity by the tax breaks, by the incentives that would be present.

Chairwoman VELÁZQUEZ. Mr. Joyce, I have introduced the Small Business Tax Relief and Job Growth Act, which will expand section 179 to include roofs, electrical systems, HVAC systems, and other structural improvements.

Do you believe that these incentives would encourage businesses to make those investments now? And is it enough to help businesses overcome the challenge of up-front costs?

Mr. JOYCE. Absolutely. And by allowing that early and quick depreciation, it is just enough to bump them off doing nothing. And right now we see businesses make repairs to old, inefficient machines that if there was just a little extra incentive out there for them to go ahead and buy a new efficient machine with better refrigerant, more environmentally friendly operating characteristics, they would do that.

What I have told some folks, the way the depreciation schedule is on HVAC now, you almost have to pay for the equipment twice when you buy it. You write a check to me when it is put in. But then you have got to gross up your income 30, 40, 50 percent to offset that because it is after-tax money. And then you have to depreciate over such a long time you never recoup it. So it is almost like a double payment where the changes that you have introduced would give immediate relief.

And folks are sitting there waiting for an excuse to act. And we see and we saw it residentially with the $1,500 credit for energy efficiency upgrades that literally kept us from laying off a single person over the past year. So yes, absolutely.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Graves?

Mr. GRAVES. Thank you, Madam Chair.

My question is to all of you. And whether it is your individual business or your members, you can comment. We have got the 2001-2003 tax cuts expiring, which is going to raise the marginal rate structure.

I am curious how it is going to affect your members, specifically if you are filing. You may have your business, but you may be filing as an individual or as a couple, whatever the case may be. But I would be very curious, Mr. Koenig.

Mr. KOENIG. Thank you, Ranking Member Graves.

Certainly the National Restaurant Association, we represent all restaurants, from the local entrepreneur with one establishment to multinationals. As I said earlier in my testimony, most of our members are your traditional small businesses.

Almost two-thirds of our membership operate as so-called subchapter S corporations. So for those who are in the 33 percent or 35—and, of course, for tax treatment purposes, S corporations, the income flows through to the individual shareholders. For those in the 33 percent rate and the 35 percent rate, they will see their taxes increase if nothing is done before the end of the year.

Mr. GRAVES. Mr. Joyce?

Mr. JOYCE. It is a very difficult time. It is a very difficult time to see any type of increase because, you know, most of us are living right on the edge, whether profitable or not profitable.

If that rate goes up, all of our banks sit and look at our financial statements and our balance sheets. And we may have made commitments to buy capital and things that we are paying with after-tax dollars.

Maybe it is a business buyout from a family member or whatever. And every time these things change, they have dramatic impact on our cash flows, what we are showing in our banks, and how we move forward, whether we can invest, buy that next truck or whatever that is.

So I can't say enough how important it is to get some stability across the board in some of these tax areas. And I think the velocity—you know, if we can get business growing, the velocity of new business and paying at a little bit lower rate will far outpace what you would get from an increase.

And, again, I feel so backed in a corner as a business person because every penny of my after-tax money is committed to do something with. So if taxes go up ten percent and we expect a tough couple of years, it really puts me in a jam, particularly on the credit side. A lot of people don't think about that.

So anything you can do to help and just get stability there, just don't increase it. If you leave it where it is, we will make it work, but if you keep going every which way because we have already got, you know, health care increases and other areas that we have got to pay. So anything that can be done to stop that will be a big help.

Mr. GRAVES. Mr. Collins?

Mr. COLLINS. And to echo, NRCA membership as a whole, you are roughly talking about 97 percent of our membership would fall in what the government would quantify as a small business. So when I speak to the effect personally, I am speaking to the effects of the association as a whole and its membership base.

And it would be the same. I mean, the fear that is out there is stagnating growth. And uncertainty is compounding that problem. And whether it is through stability or whether it is through stimulating activity like GREETA, those are the things that we are looking for and trying to encourage.

Mr. GRAVES. Mr. Green?

Mr. GREEN. I would echo those comments. I think anything we can do to keep the tax rates from going up would be beneficial to all the small business owners, not just the architects but, as we have heard at this table, anybody that is working hard right now to keep food on their table that lower tax rates would be critical.

Our industry is absolutely subject to the credit market. And, in addition to keeping the taxes low, what we really need to do is we

need to get control of the credit markets so that we can be putting projects on the boards that these gentlemen can be working on. And until we get those credit markets stabilized and we get strong rules on them, it is not just the taxes, but it is the credit markets that are affecting our industry in an enormous way.

Mr. GRAVES. Mr. Dubay?

Mr. DUBAY. Raising taxes on small business at any time is not a good idea, but doing so now seems particularly unwise. We often hear it argued that raising the top two rates wouldn't impact small business because only a few of them will actually pay that.

Well, like I said in my testimony, according to the Treasury Department, it is true that only eight percent of small businesses pay at the top two rates, but those small businesses earn a vast majority of the income earned by small businesses and pay almost all the taxes paid by small businesses.

They are the biggest ones that create the most economic activity. They are the ones we need to help pull us out of this recession or get the recovery going and creating jobs. Now is not the time to raise taxes on them.

Mr. GRAVES. Okay.

Chairwoman VELÁZQUEZ. Mr. Moore?

Mr. MOORE. Thank you, Madam Chair.

None of you want to see tax increases on small business or tax increases generally, I think. And I don't personally like tax increases either. When I came into Congress in 1999, the national debt was about $5.8 trillion. The next two years, there were balanced budgets both years and no additional debt. The next 8 years under the President Bush, we accumulate more than $5 trillion more debt, almost double, almost doubled.

What do we do? How do we get back to fiscal responsibility and start living within a budget like most, not all but most, American families do if we are not going to do something with this tax situation to try to deal with this horrible debt that we have and passing this horrible debt onto future generations, our children and grandchildren?

We start down here and just move down the line.

Mr. KOENIG. Congressman Moore, I wish I had an answer for you. Obviously—

Mr. MOORE. I do, too.

Mr. KOENIG. Obviously it is a difficult situation, so difficult that the President has gotten a commission together, a bipartisan commission, to try to examine all of the issues and putting everything on the table. I would say that that is probably what needs to be done, is having everything examined at once and hopefully a solution.

Mr. MOORE. Thank you. Can I stop right there and go back here and then go down this way, please? And we have 3:19. I sure would like to hear from all of you. If you can each take just about 45 seconds or something, we can get this in. Thank you. Mr. Dubay?

Mr. DUBAY. Well, if you look at the projections from the Congressional Budget Office for the end of this decade, tax revenues will be back to 18 percent of gross domestic product. That is where we were for the last 60 years, about the average.

Over that time, we averaged spending about 20 percent of GDP. So we had a deficit somewhere around two percent of GDP. That is sustainable, more sustainable than the course we are on. It is not perfect, but it is better than where we are.

And if you take the new health care legislation, the new law, the tax revenues would actually be higher than 18 percent, the post-war average.

So my point is that we have a spending problem, not a taxing problem. If spending is brought back down to historical averages, the deficit will be brought back down as well.

Mr. MOORE. Mr. Green?

Mr. GREEN. I would submit that we have got short-term and long-term issues here. The short-term is everybody wants to get the deficit down, but we are also in an economic situation where we can't generate the income to tax right at the moment.

So if we can figure out elements that we can address right now makes sense, but we also have to look at the long-term, as Mr. Dubay here says, of saying, how do we stimulate the spending so that we can legitimately get tax revenue back up to where it once was? And then we can deal with the spending issues. I think it is a balanced approach. And I think that makes a lot of sense in the overall scope of what you are asking.

Mr. MOORE. Thank you, sir.

Mr. Collins?

Mr. COLLINS. I agree and would like to see just the ability to operate day to day and not have the restrictions and regulations that we see increasing at what appears to be more regularity so that we can continue to create jobs, that we can continue to—we are fortunate.

And, again, our size is representative of average membership, where we create jobs that are across anywhere from office staff to field technicians, mechanics, superintendents. We have a wide range of employment and feel like when left alone and left to be creative and left to do what we do, we have the ability to generate more revenues and more income for those employees.

Mr. MOORE. Thank you.

Mr. Joyce?

Mr. JOYCE. I would just say currently be gentle with the tax increases to get our velocity back. If I had my druthers, I would just look at our total budget, and I would roll it back a couple of percent every year for the next few years.

I would focus across the board, everybody, just like we have done in business in America. Every household in this country has rolled their budget back.

And I would said, military, you are going to get across the board. Gentle on taxes. Let's see what traction we get. And then there are a lot of things that are off the grid that aren't taxed. And the tax has gotten to the point where things are outside of the system. We need to get those back in the system and then move forward.

And I think we can get the two across relatively quickly, but it has got to be a team effort.

Mr. MOORE. Thank you. Thank you, Madam Chair.

Chairwoman VELÁZQUEZ. Time has expired.

Mr. Thompson?

Mr. THOMPSON. Thank you, Madam Chair, Ranking Member, for this important hearing. And thanks to all of the witnesses today for your expertise and representing all of those small businesses that you do.

I certainly agree that the mounting debt is a problem. It provides us a really rocky terrain to do business in. And I appreciate what the debt has been accumulated over the years.

I certainly want to note, though, that President Obama's doubling down on the debt in the past 16 months has really taken us to the edge of a cliff. We need to reverse direction. And I think that we are all in agreement with that.

Mr. Dubay, I wanted to ask you. Last Wednesday this Committee did a hearing on trade and small business. I happen to believe that for our small businesses, where we can, that is an important market to reach out to the rest of the world.

I want to get your opinion on—we have, I believe it is, the second highest corporate tax rate in the world. And many of our small businesses incur that burden. Your opinion on, is that a disadvantage and how to our small businesses to compete?

Mr. DUBAY. The corporate income tax rate is a huge disadvantage for American businesses. Right now our rate is the second highest in the developed world. We trail only slightly Japan.

When you take the top federal rate at 35 percent and add on state corporate tax rates, it gets pretty close to 40 percent. That is, like I said, higher than almost every other developed country. It is one of the major factors driving businesses overseas, driving them to open up new operations overseas, send jobs overseas.

The average in the Organization for Economic Cooperation and Development, the 30 largest economically developed countries, is about 25 percent. So we are ten percentage points over that rate.

Over the last 10 to 15 years, most countries have been cutting their rates. I think every country except us cut their rate over that period. So by standing still, we have fallen behind.

It is absolutely imperative that action be taken soon. Otherwise we are going to keep seeing jobs go overseas.

Mr. THOMPSON. Okay. Thank you.

Mr. Green, in your testimony, you said that billings at your company are down due, in part, to tight credit, the result, you say, of conflicting bank policies and additional requirements. Now, you believe the financial regulatory reform legislation being considered by the Senate will add or reduce the tight credit?

Mr. GREEN. I am hopeful that it will increase the credit available. I think what we are seeing is there are enough mixed signals in the credit markets that there is inconsistent policy that we are seeing right now that says, what is your loan-to-value ratio? What is the consistent loan-to-value ratio? What are the incentives? What are the capital requirements on a project that is being considered? And then what are the pro forma requirements for that in order for the financing to be considered a solid financing package for our client?

So hopefully we will see that, but we need to get that under control and get a consistent level of rules and regulations in right now.

I think we spoke a little bit to the fear factor. There is a significant uncertainty on Main Street about what is being asked of and

required of folks that are thinking about really good projects right now.

Mr. THOMPSON. I see that in my discussion with job creators. And you represent the job creators. They are sitting on the sidelines. They are normally small men and women who take a percentage of their profits, reinvest it in their company, hire more people. And they are afraid. They are sitting on the sidelines.

Mr. Collins, you mentioned in your testimony about the effect of tight credit. Do you believe that credit markets are easing for small companies? What are you seeing out there?

Mr. COLLINS. I don't believe so, no. You know, we rely on not only what we see but some pretty substantial indicators as well that either confirm or deny what we are seeing in-house. And one of those is activity of general contractors, the other being the activity in the surety market. Those are really strong indicators of what is going on around us.

I can say with certainty from either conversations that we have had with both or with just real examples of what we have experienced that there is no movement and no encouraging outlook there. If anything, it is the opposite. It is that the commercial element of what we do has really yet to potentially fully bottom. And when it does, the idea that there is going to be a rebound of any sort is not there.

If it hasn't bottomed, once it does, it is going to bounce there. And the surety underwriting market is shrinking today.

Mr. THOMPSON. Yes. Thank you, Madam Chairwoman.

Chairwoman VELÁZQUEZ. Time has expired.

Chairwoman VELÁZQUEZ. Ms. Dahlkemper?

Ms. DAHLKEMPER. Thank you, Madam Chair.

I want to say as a business owner, bonus depreciation has been something we have used successfully in keeping our fleet modern and buying equipment to make us more efficient and look forward to seeing that type of legislation move forward.

I wanted to ask all of you just real quickly because we have votes and I only have five minutes here, but do you feel the IRS adequately is providing the business community with the information that you need so that you know what tax incentives are out there for you? And just very quickly, if you can let me know how you find out what is out there for your industry? And if you could just give me a short answer, Mr. Koenig?

Mr. KOENIG. Congresswoman Dahlkemper, we try to keep on top of things within the restaurant industry and feed information out to our members constantly through a combination of working with the IRS on new forms, on new laws, working with our state partners. We think that they do a pretty good job of keeping us informed.

However, I find them I think probably overburdened in the years to come with a lot of the new responsibilities that the health care law has placed on the IRS. So I think it will be interesting to see how their level of service to the small business community is impacted by that.

Ms. DAHLKEMPER. Mr. Joyce?

Mr. JOYCE. Typically we get our information from our CPAs as we go through the review. We really count on them to back into

what is appropriate for us and what is not appropriate to us. So we feel like it is the IRS's job to—

Ms. DAHLKEMPER. So your CPAs are doing that?

Mr. JOYCE. Yes, they are doing that.

Ms. DAHLKEMPER. Thank you.

Mr. Collins?

Mr. COLLINS. The same.

Ms. DAHLKEMPER. Okay. Mr. Green?

Mr. GRAVES. We have CPAs, but we also have clients that are trying to work through some of the energy credits and some of the sustainability issues. And some of that gets a little convoluted and tough to understand. Whether it is a credit, whether it is an additional line item on the taxes, those could be a little more clear to us.

But we are with these guys. The CPAs provide a lot of information. Every now and then, they get confused. I am not sure tax regulations are that simple.

Ms. DAHLKEMPER. No, they aren't. That is why I was wondering how each industry—Mr. Dubay, I have a separate question for you. You had mentioned that in your testimony, you had said that the death tax, the estate tax, you said it raises little revenue I think were the exact words you said. And it is estimated that for 2009, there will be 14,900 estate tax returns filed; of those, 5,500, actually very few, across the country who will owe that estate tax. But it is going to total $13.8 billion.

Do you think $13.8 billion is just a little bit of revenue?

Mr. DUBAY. Well, compared to the total federal tax revenues, yes. I mean, the federal government collects about $3 trillion a year.

Ms. DAHLKEMPER. Okay. But if we don't have the $13.8 billion, what are we going to do about making up that amount of money?

Mr. DUBAY. Well, there are actually studies that show that if you repealed the death tax, you would get increase in economic activity so much that it would make up for all of the revenue on the income side.

Ms. DAHLKEMPER. I don't think I totally agree with you on that. Last year we tried to pass a permanent fix because, as some of the business owners mentioned here, part of the issue with business—and I say this as somebody who has a business back home—it is the uncertainty.

So this year the estate tax has gone back down to zero. And next year it is going to go to a million. Last year it was 3.5 and 7. And so we tried to fix that in December. We passed a bill through the House to permanently fix the 3.5 and 7, which it seemed most people in my district were very comfortable with. And it would give some certainty to business owners and farmers and people who may have enough in their state to cause that to be an issue for them.

So I guess I am just questioning that we have got 5,500 people who may owe this in 2009, bringing in $13.8 billion raised. Of course, this year in 2010, it is expected that 70,000 people will be affected because, again, the uncertainty with allowing that fix that we had tried to get through the entire Congress didn't pass. I guess I just want your opinion on that.

Mr. DUBAY. Right. I agree that stability matters. All businesses crave it. But it doesn't matter how many estates are being impacted by the death tax. What matters is the economic impact that is created by that tax.

What we have seen is that it is a huge economic impact. Businesses, especially small family-owned businesses, get hit particularly hard. They can't afford the expensive preparation that bigger, larger estates can afford.

So when the death tax hits, they are often stuck with large bills. And they have to liquidate part of their firms or the whole thing. That means they cost people their jobs. That means the business cannot expand.

Chairwoman VELÁZQUEZ. Time has expired.

Ms. Clarke?

Ms. CLARKE. Thank you, Madam Chair.

It is a very interesting debate because we are trying to find the balance. And I don't know how you necessarily strike a balance. But that is why we are trying to get informed by you.

Clearly we don't want to inhibit innovation. We don't want to inhibit business growth and expansion. But, like all other entities in the United States of America and individuals, there is an expectation that there is going to be revenue generated.

So my question to you is, giving through to where we are right now in the development of our economy and given the fact that there are a number of tax incentives made available to small business, where do we draw the line? Where do you feel that there is an obligation for you to pay revenues, to pay taxes?

Mr. Dubay, your answer at one point was that, well, you don't feel that it is appropriate to pay taxes, there is never really a good time. You know, if you were negotiating, what would you say is appropriate?

Mr. DUBAY. What I said is it is never a good time to raise taxes, not to pay taxes. We should all pay taxes. We all have an obligation to pay them.

But from an economic standpoint, there is never a good time because all tax increases, all taxes have economic drag. So raising them during a recession seems unwise to me. Even though we are not in a recession anymore, we are trying to recover. But as recovery is trying to take off and still going slowly, it seems unwise to raise them now.

I mean, at the very least, I would suggest extending the 2001-2003 tax cuts for at least the next couple of years.

Ms. CLARKE. So you feel that extending the tax cuts would give you sort of the ground you need to sort of lift the companies? Is that your contention?

Mr. DUBAY. I will leave that to the other gentlemen, who can speak more personally to that.

Ms. CLARKE. Okay.

Mr. DUBAY. But I would say so, yes.

Ms. CLARKE. Would anyone else care to? Please?

Mr. JOYCE. It would be a big help to not have—you know, in a lot of the businesses, when you get into rates, you know, most of us are in the 40 to 50 percent when you look at the fed and state and add it together if it's an S.

And I think that when you start going past that, you grind up so much disposable capital it becomes very difficult to do things, create jobs, take risks because you are always trying to leave a cushion. And if the taxes take the cushion, you get into the fear slot. So anything that can be done to moderate and flatten them?

And I would just like to say one thing on the death tax. Having gone through a very difficult transfer between the death of my mother and the father to the business to me and buying my sisters out,—and they did an incredibly good job of planning—it was so difficult you cannot imagine the pain it puts on a family.

And if we could come up with some 20-30 percent number and call it a transfer tax and just let us transfer at any time you want and not make it happen at death. Causing everything to go down in the nine-month death period is so difficult.

I have got your attention. If there is anything that could ever be done, it would be wonderful because it is so difficult, having done it.

But back to the tax part, my late father said, "And it is our duty to pay tax. And I want to pay tax."

Ms. CLARKE. Yes.

Mr. JOYCE. I would like to just keep it in a gentle ramp and have everyone doing it and have everyone playing, rather than it be punitive in one direction or another.

Ms. CLARKE. Thank you very much, Madam Chair.

Chairwoman VELÁZQUEZ. Mr. Joyce, what would you think is—what will stimulate the economy? If we cut taxes to 95 percent of American families or just 1 percent of American families, we need to increase consumer spending. What will generate the type of activity in terms of consumers: the 1 percent cut to the wealthy families or the 95 percent to all American families?

Mr. JOYCE. I think a combined approach would do it, some incentives for the families where it is that piece. And if we could take the 1 or 2 percent that are paying 50-ish percent—and I am not asking for tax decreases.

I would also say I think we are very close to a breaking point for medium to large or small—you have got little teeny smalls, and then you have got this medium group of smalls, which I kind of fall in. We are real close to a breaking point.

And I think if we could just be given a cushion and no more increases, let it all settle out, we will drive it and give the 95 percent incentives.

Chairwoman VELÁZQUEZ. That balance was what we tried to do in the stimulus package, where so many tax cuts and credits were provided to small businesses because you are the ones creating the jobs that we need in order to get this economy growing again.

Mr. JOYCE. Thank you. And it is working.

Chairwoman VELÁZQUEZ. I ask unanimous consent that members will have five days to submit a statement and supporting materials for the record. Without objection, so ordered.

This hearing is now adjourned. Thank you.

[Whereupon, at 2:09 p.m., the foregoing matter was concluded.]

NYDIA M. VELAZQUEZ, NEW YORK
CHAIRWOMAN

SAM GRAVES, MISSOURI
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
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STATEMENT
Of the Honorable Nydia M. Velázquez, Chairwoman
United States House of Representatives, Committee on Small Business
Full Committee Hearing: *"Tax Initiatives that Promote Small Business Growth"*
Wednesday, May 5, 2010

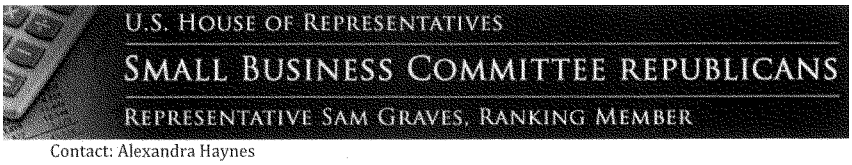
In recent weeks, our economy has shown promising signs of recovery. Gross Domestic Product grew at 3.2 percent during the first quarter of this year—marking the third straight quarter of economic growth. Consumer spending is on the rebound—March saw the sixth straight month with a rise in individual spending. Most importantly, the U.S. economy added 162,000 jobs in March—the largest increase in nearly three years.

The American Recovery and Reinvestment Act fueled much of this progress. Not only did that measure boost infrastructure spending, it provided billions of dollars in tax cuts—including $15 billion in targeted tax relief for small firms. Today's hearing will allow the Committee to analyze how tax policies can sustain and further accelerate our economic recovery going forward.

Since the Recovery Act's passage, we've built on its momentum, extending many provisions that would have otherwise expired at the end of 2009. More recently, the HIRE Act was enacted, providing a tax credit for small businesses that bring on new employees. It also extended a credit for entrepreneurs purchasing business equipment—helping firms to expand and stimulating demand for everything from trucks to computers to machinery. Our witnesses today will be able to give us an assessment of how well these initiatives are working—and how to improve them.

In every previous economic recovery, small firms have led the way, creating more jobs and generating them more quickly than their big business counterparts. Following the recession of the early 1990s, small firms created 3.8 million jobs. After the recession of 2001, micro-businesses alone generated one million jobs. Entrepreneurs will be just as important to bringing our nation out of today's downturn—but only if they have the right tools.

While showing promising signs, today's recovery is in its earliest, most fragile stages. As our recovery gains traction, it is vital that our tax policy promotes small business job growth—and does not hinder it. In that vein, it is my hope that today's hearing will help improve on existing tax programs, while generating new ideas for targeted tax relief.



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Opening Statement for Hearing:
"Tax Initiatives that Promote Small Business Growth"
Sam Graves
Ranking Member
House Committee on Small Business
United States House of Representatives
Washington, D.C.
May 5, 2010

Madam Chairwoman, thank you for calling this hearing on the critical topic of tax initiatives that promote small business growth. I'd also like to thank our witnesses, some of whom have taken time away from their companies to be with us today.

The economy is still struggling, and the outlook is still uncertain. Foreclosures, credit card defaults and bankruptcies remain high. Unemployment is still almost 10%. For businesses, especially small ones, capital markets remain tight, and few are expected to expand or hire. Companies remain skeptical about a lasting economic recovery.

Small businesses are reeling from the news that under the new health care law, they will be forced to provide health insurance or pay a penalty. And that's in addition to the myriad of new regulations and reporting requirements.

Here's just one example: section 9006 of the new law requires businesses to submit a Form 1099 for every business to business transaction of $600 or more of property and services. Small businesses already bear a heavy burden of paperwork compliance. This is another example of forcing small business owners to take more time away from their business to comply with an

unnecessary mandate. Of course, the small business owner could choose to outsource the paperwork to an accounting firm. Either way, the entrepreneur loses scarce resources that could be spent gaining more customers or producing more products. Higher taxes, more mandates, new regulations and piles of paperwork do not foster an environment that is conducive to creating jobs.

Taxes are a constant concern for small companies. In this economic climate, every expense is an added burden. Small businesses pay more per employee to comply with the tax code, and often can't afford experts to help navigate through it.

Entrepreneurs depend on tax incentives to offset some of the cost of innovation and expansion. While I support temporary tax provisions, or "extenders," because I know they are critical for small companies, their temporary nature causes uncertainty. Not knowing whether these tax provisions will be renewed makes it difficult for small businesses to plan for future growth. I also believe we must make permanent the 2001 and 2003 tax provisions, which lowered marginal rates. That's why I introduced legislation to do just that.

Finally, I want to say a word about the estate tax, and my support for its complete repeal. If Congress does nothing, a top marginal rate of 55% and an exemption of just $1 million will again take effect in 2011. Small businesses and farms are often operated by families and transferred from one generation to the next. To pay the estate tax, heirs could
be forced to sell the very land and equipment that is needed to operate the family business. As you have heard me say before, death should not be a taxable event. We must kill the death tax.

Madam Chairwoman, thank you for holding this hearing on the vital subject of taxes. I look forward to the testimony of our witnesses.

Testimony of

Hugh Joyce, Jr.

President

James River Air Conditioning

Richmond, Virginia

On Behalf of the

Air Conditioning Contractors of America (ACCA)

Submitted to the House Small Business Committee

Full Committee Hearing on

"Tax Initiatives that Promote Small Business Growth"

2360 Rayburn House Office Building

May 5, 2010

Chairwoman Velazquez, Ranking Member Graves, and members of the House Small Business Committee, thank you for the opportunity to provide testimony on behalf of the small business service contractors of the heating, ventilation, air conditioning, and refrigeration (HVACR) industry.

My name is Hugh Joyce, Jr., and I am the President of James River Air Conditioning Company, a family-owned business located in Richmond, Virginia. Our company offers maintenance, repair and installation services for heating, cooling, air quality, electrical, and plumbing systems to residential and commercial clients throughout Central Virginia. My father started James River Air Conditioning Company from very humble beginnings in 1967 as a one man, one truck operation.

This afternoon I come before you as a member and former Board Member of the Air Conditioning Contractors of America (ACCA). Every day, more than 4,000 ACCA member companies across the nation help homeowners, small business owners, and building managers realize the comfort, convenience, and cost benefits of energy efficient HVACR equipment. Eighty-four percent of ACCA's member companies have fewer than 50 employees, and 60% have fewer than 20 employees.

It's an honor to present testimony before you today and I want to thank the Committee for its leadership in promoting and protecting the interest of the great economic engine known as America's Small Businesses.

My comments today will focus on energy conservation tax incentives and how they can benefit both residential homeowners and commercial building owners, but also the small businesses of the HVACR industry that serve them. I hope that my testimony will inform future policy decisions that further assist small businesses in these trying economic times.

Success of the Federal 25c Residential Tax Credits

ACCA members found the federal Section 25c and 25d tax credits to be an effective financial incentive to encourage homeowners and building owners to reach for and obtain higher efficiency HVAC equipment while stimulating economic activity. Section 25c and 25d allow eligible taxpayers who install qualified new furnaces, boilers, central air conditioners, heat pumps, and hot water heaters in their homes to claim up to $1,500 in tax credits in the year the energy conserving appliance was placed into service.

Retrofitting HVACR and hot water appliances can be an expensive investment in a home. These tax credits help soften the initial costs and shorten the payback period.

And even though these tax credits are aimed at individual taxpayers, these valuable incentives helped the small businesses of the HVACR industry.

A little more than a year has elapsed since Congress passed the stimulus bill that extended and expanded the Section 25c and 25d tax credits for energy efficient improvements.

Based on member surveys, many of ACCA's member companies have seen positive benefits from these tax credits. But there is still work to be done to get the economy moving again. In a survey conducted in preparation for my testimony today, 46% of ACCA's contractor members saw a "significant" increase in the sale of qualifying HVAC equipment after the passage of the stimulus bill. Another 32% saw a small increase in the sales of qualifying HVAC equipment. When taken in tandem, more than 75% of ACCA's contractor members have seen an increase in the sale of qualifying higher efficiency equipment.

Our survey had a number of positive comments from members:

> "Without the stimulus bill for 95% efficient furnaces we would have had an extremely bad time of it last year. The stimulus helped us to stay in business and helped a lot of consumers as well.
>
> "My business has grown and prospered through our down economy and my customers are more than ever more comfortable and saving more money month to month for the more precious things in life such as their children's well fair."
>
> "It is crucial that these tax credits stay in effect as proposed and not cancelled prematurely."
>
> "Thank goodness for the tax credits or our business would have seen a much larger drop off as people's spending habits changed whether out of concern for their jobs or due to the inability to obtain financing."
>
> "Last fall was my busiest season in the 30 years I have been in business. All of my equipment sold was top of the line high efficiency."
>
> "The tax incentive helped us not only survive a down year, but turn it into a reasonably profitable one."
>
> "Without the $1500 tax credit, we would have had massive temporary and some permanent layoffs. Instead, we have been able to keep steady work during a traditionally slow time."

Indeed, the higher value tax credits are helping homeowners elect to replace equipment that may be in need of repair, reversing a three year trend in the industry.

Next Steps

These job creating tax credits are set to expire at the end of this year. In order to keep this momentum going, I recommend that Congress extend, modify, and expand the 25c credit so that taxpayers can continue to make energy efficient retrofits to their homes.

1. Extend the 25c tax credits for 2011 and 2012

ACCA recommends that Congress extend the 25c tax credits for another two years in a way that "wipes the slate clean" so that taxpayers who may have already claimed credits

for improvements to their HVAC systems, windows and doors, insulation, or hot water heaters, should be given another two years to make another type of retrofit improvement.

2. Modify the 25c tax credits

We also recommend modifying the tax credit criteria to address an issue that is limiting the tax credit's applicability. Due to changes to the qualifying criteria, many homeowners have been unable to claim tax credits for central air conditioners. The stimulus bill raised the minimum qualifying energy efficiency rating from 15 SEER and 12.5 EER to 16 SEER and 13 EER. SEER and EER are measures of energy efficiency, similar to miles per gallon in an automobile. This seemingly slight uptick has had unintended negative consequences for homeowners and the HVAC industry. As a result some homeowners cannot justify the higher costs of a qualifying system, even with the tax credits. At the same time, many larger systems cannot meet the new 16 SEER/13 EER minimum standard, all but disqualifying them from the tax credits. A frequent comment we have heard is that customers would like to upgrade their old equipment but the bar has been set too high for the average homeowner.

3. Expand the tax credits to include more homes

Another limiting factor is the fact that the 25c tax credits may only be claimed for qualified improvements to the taxpayer's primary residence. As Congress considers renewing the tax credits, we would also recommend that second homes should be made eligible.

Home Star

Congress is considering a new incentive that would further encourage energy efficient retrofits. HR 5019, the Home Star Energy Retrofit Act of 2010 is scheduled for a House floor vote tomorrow. Modeled after the Cash for Clunkers program, Home Star is a $6 billion program designed to encourage energy saving retrofits, lower homeowners' utility bills, and create jobs. While not a tax incentive, the Home Star rebate program would provide instant rebates at the time of installation for eligible residential energy efficiency improvements. The rebates can only be offered by qualified contractors who are licensed in their state, hold $1 million in general liability insurance, and agree to warrantee their work for one year.

Rebates would be offered in two tiers, Silver Star rebates of up to $3,000 for eligible equipment retrofits, and Gold Star rebates that could total $8,000 for improvements that results in demonstrative overall energy savings to the whole house.

Under Home Star, contractors, not the homeowners are the entity filing for the rebates. Only qualified contractors who have aligned with a DOE approved Rebate Aggregator can offer Home Star rebates.

Before offering any Silver Star or Gold Star rebates to a homeowner, a contractor must enter into a participation agreement with a Department of Energy designated Rebate Aggregator and demonstrate they are a Qualified Contractor (see below). The Rebate Aggregators will be responsible for processing rebate requests, remitting payments to contractors, and verifying that installation jobs are performed correctly.

In order to be a Qualified Contractor, a contractor must: Meet their state's licensing requirements; have at least $1,000,000 for general liability along with insurance coverage for other purposes set by your state; agree to provide warranties that completed work will be free of significant defects and be installed in accordance with the specifications of the manufacturers, and perform for a period of at least one year after the date of completion; agree to pass through the full economic value of the rebate to the owners of the home; and provide the homeowner a notice of the rebate amount before the contract is executed with the homeowners for all eligible work.

Any contractor who wishes to offer Gold Star retrofits to homeowners must to meet all of the above criteria, plus: be accredited by the Building Performance Institute; and perform a whole house simulation with documentation of energy savings demonstrated.

ACCA is encouraged to see a robust rebate program in Home Star to compliment the tax credit incentives to homeowners who make energy efficient improvements under IRS Section 25C.

Commercial Incentives
While the 25c tax credits have helped homeowners and the residential HVACR contractors, Congress needs to create federal energy conservation incentives for the commercial building sector.

ACCA members that work on commercial buildings see the outdated equipment in use every day and can attest to the increased savings and reduced energy use from properly installed and maintained HVACR equipment.

We know commercial building owners are hungry for incentives to make energy efficient improvements. Just look at my State's Solar and Wind tax credit program where Round 1 and Round 2 of funding were claimed in 6 hours. There is an appetite for investment I assure you. There is a significant amount of deferred maintenance in the market and this type of work will drive growth while the new construction market sorts itself out over the next two to five years.

Regrettably there are few federal incentives for commercial building or rental property owners who want to make energy efficient improvements. In fact, under current law, most commercial HVACR equipment must be depreciated over a thirty nine year period. When you consider that properly installed and maintained equipment is expected to last between fifteen and twenty years, there is almost no incentive to replace at all.

Every building is unique and Congress should consider providing several paths to encourage more energy efficiency improvements to the variety of commercial buildings. As Congress considers ways to help the commercial sector, it should include these incentives.

Section 179 and Bonus Depreciation
Under Section 179 of the tax code, small businesses may elect to expense the costs, up to $250,000, of qualified capital improvements in the year they are placed into service. While many small businesses use Section 179 to make capital improvements through the

purchase of new trucks, computers, and machines, a large capital expenditure on building property, such as commercial HVACR equipment, does not qualify.

ACCA applauds the introduction of HR 4841 that would remedy this by expanding the definition of a qualified structural improvement under section 179 property made in 2010 and 2011 to include any improvement to a building or its structural components (including improvements to the roof, drainage, plumbing, electrical components, heating, ventilation, or air conditioning, insulation, fire protection) intended to improve or make such building ready for use in a trade or business.

A change in the tax code like this will also help many small firms located in commercial properties like professional townhouse suites, doctor's offices, and strip malls that use smaller and less expensive commercial HVAC equipment afford energy saving retrofits.

In the past, Congress has passed a short term allowance for businesses to use Section 179 "bonus depreciation" so that owners could claim up to 50% of a qualified property's value in the year it is placed into service. That allowance expired at the end of 2009. Bringing back the bonus depreciation will encourage companies of all sizes to invest in newer, more efficient, and more environmentally friendly equipment.

Expand the Commercial Building Tax Deduction
Section 179D, the Commercial Building Tax Deduction, does allow a $1.80 per square foot tax deduction for building owners who make qualified improvements in overall performance. Unfortunately the incentive falls short and is not meeting expectations. Although the deduction has been successfully used to build and retrofit larger energy efficient buildings, the economic crisis has reduced the amount of building design, construction and renovations across the country. In addition, because some energy efficient systems are more expensive to design, build, and install than their less efficient counterparts, the initial increased capital costs often dissuade owners from installing these systems.

ACCA supports the passage of HR 4226, the Expanding Building Efficiency Incentives Act of 2009, which would increase the maximum allowable deduction from $1.80 per square foot to $3.00 per square foot ($1.00 in the case of individual subsystems) to create jobs. By increasing the deduction to $3.00 per square foot, Congress could immediately stimulate building design, construction, and renovation across the country, spurring job creation in every state and region, while enhancing our energy independence and improving our nation's infrastructure for the 21st century.

Consumer Credit
Finally, I would not represent the interests of my fellow contractors if I did not mention one issue that has impacted the entire small business economy – access to credit. The tightening credit markets have hit both the small business members of ACCA and their residential and commercial customers. Many homeowners use short term credit to finance new HVAC equipment. More and more consumers are finding it harder to get financing, or financing on good terms, to pay for these energy efficiency improvements.

Home service contractors rely on partners to help homeowners finance what can be an expensive home improvement. The options are dwindling for homeowners who want to finance an energy efficiency improvement. Banks are reluctant to make unsecured loans and finance companies are leaving the marketplace.

Conclusion

Let me finish by saying fear is the most crippling emotion. American businesses managers and owners are currently crippled by fear - fear of the unknown of what Washington will toss at them next. The people I speak with on a day to day basis are afraid to do anything right now because they are concerned about the impacts of new taxes through a cap and trade policy on greenhouse gas emissions, health care, and other new government regulations and rules enforcement.

By sending the right signals to America's small businesses, Congress can eliminate the fear of the unknown in the future. We all need clear communication of what is coming next and what needs to be done and I assure you American Business will rise up and create new jobs.

With that I will conclude my comments and would be happy to answer any questions you may have. Thank you again for this opportunity to testify before you.

REPRESENTING THE RESTAURANT INDUSTRY
The Cornerstone of the Economy, Career Opportunities and Community Involvement

Written Testimony

Of

Dave Koenig, Director, Tax and Profitability, National Restaurant Association

For The Hearing

"Tax Initiatives That Promote Small Business Growth"

Before The

U.S. House Of Representatives Committee On Small Business

On Behalf Of The

National Restaurant Association

Wednesday, May 5, 2010

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Chairwoman Velazquez, Ranking Member Graves, members of the House Committee on Small Business, thank you for the opportunity to testify before you today on behalf of the National Restaurant Association. My name is Dave Koenig, Director of Tax and Profitability at the National Restaurant Association. I am here today to ask Congress and this Committee to make permanent certain expiring tax provisions, such as the 15-year depreciation schedules for leasehold improvements, restaurant improvements and new construction and retail improvements, as well as the charitable deduction for the donation of food inventory. Finally, I ask that Congress increase the business meal deduction from its current level of 50 percent to 80 percent to provide additional stimulus to the economy.

The restaurant industry plays a significant role in this nation's economy. There are 945,000 restaurant and foodservice outlets in this country. Seven out of ten restaurants are single-unit operators, which means the restaurant industry is an industry of small businesses. Most eating and drinking establishments, three-quarters of the industry, employ 50 or fewer employees. Restaurants also serve as the conference rooms for many of the self-employed and other small businesses.

This year the restaurant industry is estimated to generate $580 billion in sales, with an overall economic impact of $1.5 trillion. Every dollar spent dining out generates $2.34 in business for other industries. The restaurant industry is one of the nation's largest private employers, employing nearly 13 million people, representing more than 9 percent of the job-base. We are truly the cornerstone of this nation's economy.

Make Permanent Leasehold Improvements, Restaurant Improvements and New Construction, Retail Improvements 15-year Depreciation Schedule

The 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements must be retroactively extended through the end of 2010 and, in fact, should be made permanent. Bipartisan legislation, H.R. 4306, introduced in December 2009 by Representatives Kendrick Meek (D-FL) and Pat Tiberi (D-OH) would make the 15-year depreciation schedule permanent.

The 15-year depreciation schedule has made significant capital available for restaurant owners to make capital expenditures with the tax savings. Those capital expenditures translate into jobs in the rest of the economy. In addition, a faster, more accurate depreciation schedule has a direct impact on a restaurant's bottom line. The shortened depreciation schedule provides restaurateurs additional cash flow to reinvest in their businesses, allowing them to expand restaurant jobs and contribute to the community. In an industry with median profit margins of 3 to 5 percent, every penny counts. The annual tax savings and corresponding additional cash flow realized by restaurateurs from a 15 rather than a 39-year depreciation schedule are considerable as highlighted for different scenarios in figure 1 on page 6 of my testimony.

Even during difficult economic times, restaurateurs are planning capital expenditures to improve or expand their businesses. According to the National Restaurant Association April 2010 Tracking Survey, 47 percent of restaurant operators plan to make a capital expenditure for equipment, expansion or remodeling in the next six months. The ability to plan for these

expenditures and know what the tax treatment will be in subsequent years, particularly during these difficult times, is important to those making such decisions right now.

Moreover, this provision is an important driver of economic stimulus. Making the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction and retail improvements permanent will fuel economic activity and create jobs. When restaurants invest in construction and renovations, the impact spreads through the economy. Before the economic downturn, the restaurant industry spent more than $10 billion in 2007 on construction of restaurant buildings. According to the Bureau of Economic Analysis, every dollar spent in the construction industry generates an additional $2.39 in spending in the rest of the economy and every $1 million spent in the construction industry creates more than 28 jobs in the overall economy. That means that restaurant industry construction spending created 292,000 jobs in the overall economy in 2007 and 214,000 in 2008, at a time when the overall economy was contracting.

Restaurant Spending on Construction

Year	Billions ($)	Jobs Created In Overall Economy
2004	5.2	145,000
2005	7.4	208,0 00
2006	6.6	185,000
2007	10.4	292,000
2008	7.6	214,000

Source: U.S. Census Bureau and National Restaurant Association

In fact, Congress has frequently enacted shorter depreciation schedules to stimulate the economy and create jobs. As far back as the 107th Congress, shorter depreciation schedules for different pieces of the 15-year leasehold improvements, restaurant improvements and new construction, and retail improvement depreciation provision have been included in various economic stimulus bills. Furthermore, in 1996, Congress permanently provided for a 15-year depreciation schedule for retail motor fuel outlet stores, which often compete with restaurants and retailers. Thus, fairness requires similar treatment for restaurant property.

It is also important to note that 15 years, rather than 39 years, is a much more accurate timeframe for depreciating or writing off restaurant buildings. With 133 million Americans patronizing restaurants each day, restaurant building structures experience a daily human assault unlike that borne by any other type of retail building. Restaurateurs must constantly make changes to keep up with the structural and cosmetic wear and tear caused by customers and employees. The heavy use accelerates deterioration of a restaurant building's entrance, lobbies, flooring, restrooms and interior walls. In fact, National Restaurant Association research shows that most restaurants remodel and update their building structures every six to eight years.

Extend the Deduction for Charitable Donation of Food Inventory for Small Businesses

The statistics are astounding. 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 and Congress cannot delay its extension any longer. 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 encourages donating the food to charity instead, by helping to offset the costs associated with storing and transporting the extra food.

Unlike other expiring tax provisions that can be retroactively extended without significant adverse consequences, the perishable nature of the donated product requires this provision to be in place before such food is produced and goes bad. It is critical for Congress to complete extenders legislation so that the deduction for charitable donation of food inventory apply for the remainder of 2010.

Moreover, Congress should make this tax extender permanent for all small businesses as the tax code currently does for C corporations, and has for decades. The Good Samaritan Hunger Relief Tax Incentive Extension Act (H.R. 3227) is sponsored by Congressmen Sander Levin (D-MI) and Geoff Davis (R-KY) in the House and would expand and make permanent this tax extender provision for small businesses to donate food inventory to charity. The Senate companion bill (S. 1212) is sponsored by Senators Lincoln (D-AR), Lugar (R-IN), and Leahy (D-VT).

H.R. 3227 and S. 1212 would permanently allow all qualified business taxpayers (not just C corporations) to take a special deduction for contributions of food inventory. In addition, because the need is so great in the current economic environment, the legislation would temporarily allow taxpayers to deduct the full fair market value of food inventory donations.

The National Restaurant Association strongly encourages its members to donate more food, and we recently partnered with Food Donation Connection (FDC) to do just that. 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 140 million pounds of food to non-profit, hunger-relief agencies.

I ask members of this Committee and all members of Congress to extend the deduction for charitable donation of food inventory through the end of 2010 and to cosponsor H.R. 3227 and S. 1212, the Good Samaritan Hunger Relief Tax Incentive Extension Act, which would make such deduction permanent.

Increase the Business Meal Deduction to Stimulate the Economy

The National Restaurant Association strongly urges Congress to provide additional economic relief for this nation's economy and to implement policies that will boost consumer spending. Increasing the business meal and entertainment deduction from 50 percent to 80 percent is a key

provision for small businesses. For many small companies, the ability to conduct business over a meal is their only means of advertising and marketing their business.

While officially the recession may be ending, the restaurant industry is still reeling from the effects of decreased consumer spending and increased unemployment. Increasing the business meal deduction would encourage consumers to dine out and also benefit small businesses. America's restaurants are small business' conference rooms and the restaurant table is where much business is conducted. Increasing the deduction is a benefit not only to restaurateurs and their employees, but to their guests, the many small business owners across the country.

This Committee has been a long time supporter of increasing the business meal and entertainment deduction as a means of providing a boost to the economy and tax relief for a legitimate business deduction incurred by our nation's small businesses. Last Congress, this Committee included a provision to increase the deduction from 50 percent to 80 percent in the *Small Business Tax Modernization and Stimulus Act of 2008.* While this legislation was not enacted into law, the National Restaurant Association applauds the Committee's continued leadership to restore this valuable deduction.

Representative Shelley Berkley (D-NV) is the lead sponsor of H.R. 3333, a bipartisan bill that would increase the business meal and entertainment deduction to 80 percent for all business meal users. Companion legislation, S. 2905, has also been introduced in the Senate by Senator Inouye (D-HI). An increase in the business meal deduction to 80 percent would increase business meal sales by $6 billion and create an $18 billion increase in the overall economy, according to National Restaurant Association research. The impact of the restaurant industry on the nation's economy is considerable and felt in every state (See Figure 2. We service 133 million guests every day. Every dollar spent dining out generates $2.34 in business to other industries, totaling $1.5 trillion in overall economic impact.

We appreciate the Committee's continued support for the business meal and entertainment deduction and look forward to our continued work together to enact this legislation.

Conclusion

I greatly appreciate this opportunity to testify on behalf of the restaurant industry before you today. I strongly urge Congress to retroactively extend these important tax provisions and ultimately, make them permanent.

The restaurant industry needs certainty when it comes to the 15 year depreciation schedule for leasehold improvements, restaurant improvements and new construction and retail improvements as capital expenditures are being considered and planned.

Small businesses, including restaurants, need at minimum the extension of the deduction for charitable donation of food inventory for the remainder of 2010.

Additionally, Congress should consider additional items that will help boost the economy and create jobs like an increase in the business meal deduction to 80 percent.

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

Expenditure Scenarios

Rebuild Costs:	Renovate Costs:
Quickservice - $700,000	Quickservice - $250,000
Fullservice - $1,500,000	Fullservice - $500,000

Note: Figures are based on a 24% effective marginal tax rate

Figure 2.

Estimated Impact of Increasing Business Meal Deductibility from 50% to 80%

State	Increase in Business Meal Spending 50% to 80% Deductibility (in millions)	Total Economic Impact In the State (in millions)	Total Employment Impact In the State (number of jobs created)
Alabama	$77	$155	2,464
Alaska	$17	$29	401
Arizona	$118	$235	3,125
Arkansas	$43	$87	1,451
California	$767	$1,797	20,868
Colorado	$114	$264	3,328
Connecticut	$71	$133	1,624
Delaware	$19	$35	402
District of Columbia	$31	$43	254
Florida	$368	$745	9,746
Georgia	$193	$446	5,642
Hawaii	$44	$86	1,154
Idaho	$24	$47	799
Illinois	$256	$610	7,207
Indiana	$117	$241	3,712
Iowa	$47	$95	1,544
Kansas	$46	$92	1,314
Kentucky	$78	$158	2,266
Louisiana	$81	$158	2,374
Maine	$24	$46	709
Maryland	$113	$235	2,750
Massachusetts	$161	$324	3,884
Michigan	$171	$341	5,272
Minnesota	$105	$240	3,270
Mississippi	$41	$78	1,340
Missouri	$115	$256	3,512
Montana	$20	$39	682
Nebraska	$31	$64	1,048
Nevada	$71	$127	1,703
New Hampshire	$29	$53	653
New Jersey	$170	$367	4,139
New Mexico	$37	$66	1,079
New York	$379	$751	8,855
North Carolina	$176	$371	5,435
North Dakota	$11	$20	333
Ohio	$217	$466	6,978
Oklahoma	$60	$127	2,016
Oregon	$82	$169	2,274
Pennsylvania	$212	$478	6,311
Rhode Island	$24	$45	598
South Carolina	$87	$179	2,689
South Dakota	$14	$27	458
Tennessee	$121	$272	3,531
Texas	$477	$1,164	14,109
Utah	$41	$92	1,375
Vermont	$11	$19	288
Virginia	$157	$331	4,155
Washington	$129	$279	3,419
West Virginia	$28	$47	830
Wisconsin	$100	$210	3,399
Wyoming	$10	$16	293

Source: National Restaurant Association estimates, 2009

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Statement of Chad Collins

On behalf of the

National Roofing Contractors Association

House Committee on Small Business

"Tax Initiatives that Promote Small Business Growth"

May 5, 2010

Madame Chairwoman and distinguished members of the committee, thank you for the opportunity to testify today on behalf of the National Roofing Contractors Association (NRCA) to discuss tax initiatives that will promote the growth of small businesses across the nation. I am Chad Collins, president of Bone Dry Roofing Inc., in Augusta, Georgia. I currently serve on the NRCA board of directors and the association's government relations committee.

Established in 1886, NRCA is one of the nation's oldest trade associations and the voice of professional roofing contractors worldwide. It is an association of roofing, roof deck, and waterproofing contractors; industry-related associate members, including manufacturers, distributors, architects, consultants, engineers, government agencies and international members. NRCA has approximately 4,000 members from all 50 states and 54 countries. NRCA contractors typically are small businesses, with the average member employing 45 people in peak season and having sales of $4.5 million per year.

Unemployment in the Construction Industry

As you may know, unemployment in the construction industry is an alarming 24.9 percent, according to recent data from the Bureau of Labor Statistics, and there appears to be very little relief in sight from this high level of joblessness in our industry. While it was recently reported that the economy grew at an annual rate of 3.2 percent during the first quarter of 2010, the most recent data also showed that commercial construction dropped by 14 percent in this period and residential investment fell by 10.9 percent.

Clearly, the construction industry is one of the hardest hit sectors of the economy and continues to struggle.

Given the continued highly difficult economic conditions in the construction industry, NRCA urges Congress to take immediate action on targeted policy measures that will spur job growth within our industry. NRCA strongly supports the Green Roofing Energy Efficiency Tax Act (H.R. 426) and the Small Business Tax Relief and Job Growth Act of 2010 (H.R. 4841) and believes that enactment of these initiatives will help create jobs in construction and other industries, particularly among small businesses.

The Green Roofing Energy Efficiency Tax Act Will Create Jobs

The roofing industry is uniquely positioned to play an important role in creating high quality jobs within small businesses. One of the ways that this can be done is by enhancing the energy efficiency of our nation's buildings, which has the added benefits of conserving energy and helping to achieve important environmental objectives.

The "Green" Roofing Energy Efficiency Tax Act (GREETA) will immediately create jobs among roofing contractors while also helping to conserve energy and reduce carbon emissions. This common sense investment in the emerging "green" building sector will result in more "boots on the roof" within days of enactment.

According to a study conducted by Ducker Worldwide, a leading industrial research firm, GREETA will produce the following benefits by accelerating the adoption of energy-efficient roofs within the commercial building sector:

- Create 40,000 new jobs within the roofing industry;
- Add $1 billion of taxable annual revenue to the economy;
- Provide savings to small businesses of all types through a simpler and more equitable system of taxation and lower energy costs; and,
- Reduce U.S. energy consumption by 13.3 million kilowatt hours annually and cut carbon emissions by 20 million lbs. per year.

GREETA was introduced by Reps. Bill Pascrell (D-N.J.) and Wally Herger (R-Calif.) and has over 36 bipartisan cosponsors. NRCA wishes to thank Chairwoman Nydia Velazquez and Rep. Dennis Moore for your continued support for GREETA. This legislation will facilitate greater levels of investment in green technologies and spur economic growth by amending section 168 of the Internal Revenue Code to provide a 20-year tax depreciation schedule for commercial roof systems that meet a designated energy-efficiency standard.

Passage of GREETA is necessary because between 1981 and 1993 the depreciation schedule for nonresidential property was increased from 15 years to 39 years. However,

the current 39-year depreciation schedule is not a realistic measure of the average life span of a commercial roof. The Ducker Worldwide study determined the average life expectancy of a commercial roof to be about 17 years.

The large disparity between the current 39-year depreciation schedule and the average life span of a commercial roof serves as a major incentive for building owners to delay the replacement of failing roofs. This is slowing the adoption of more advanced energy-efficient and environmentally-beneficial roofs, because an owner who replaces a roof before 39 years have elapsed must continue to depreciate that roof for tax purposes even though it no longer exists. A Treasury Department Report to Congress on Depreciation Recovery Periods and Methods (July, 2000) corroborated this problem by finding "...a 'cascading' effect, where several roofs are being depreciated at the same time, even though only one is physically present." Given this situation, many building owners choose to do only piecemeal repairs, most often with older technology, rather than replace a failing roof in its entirety with new, more energy-efficient materials.

GREETA will rectify this situation by reducing the depreciation schedule from 39 to 20 years for commercial roofs that meet the energy efficiency requirements of the benchmark Standard 90.1 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers. This will accelerate the adoption of energy-efficient commercial roofs by eliminating the disincentive in the tax code for building owners to install energy-efficient commercial roofs. As noted, this will have a positive impact on the economy and job creation by spurring greater demand for energy efficient roofs. Enactment of GREETA will benefit small businesses of all types by mitigating the "cascading effect" of having to depreciate more than one roof in instances where a roof must be replaced before the 39-year depreciation schedule has been completed.

Given GREETA's unique combination of job creation and environmental benefits, this legislation enjoys strong support among both business groups and organized labor, including the United Union of Roofers, Waterproofers and Allied Workers and the Joint Roofing Industry Labor and Management Committee. GREETA also has the strong support of numerous U.S. building material manufacturers.

I want to emphasize that GREETA will create jobs not through a special tax incentive, but by the removal of an obstacle in the tax code which restricts economic growth and impedes the movement towards "green" buildings that can help achieve important environmental policy objectives.

Targeted GREETA Proposal

NRCA is also working with union and industry partners on a "targeted" version of GREETA that is designed to maximize job creation in the short term in order to help reduce the high rate of unemployment in the construction industry. This targeted

proposal adopts key components of the Energy-Efficient Commercial Roofs Act of 2009 (H.R. 2615), legislation by Reps. John Larson (D-Conn.) and Dean Heller (R-Nev.), which NRCA strongly supports. H.R. 2615 would provide a 30 percent tax credit for energy efficient commercial roofs which meet a specified energy efficiency standard.

Recognizing the need to focus on immediate job creation, as well as current federal budgetary constraints, the targeted proposal is designed to maximize both job creation and energy efficiency in the short-term. As such, it applies only to upgrades of existing roofs and does not apply to new construction, and applies only to roofs upgraded in 2010 and 2011. To maximize the energy savings, the targeted proposal utilizes more stringent energy-efficiency standards contained in H.R. 2615. Thus, in order for the building owner to obtain 20-year depreciation as specified in GREETA, the newly installed roof must meet minimum R-values (thermal resistance) that are significantly higher than those required under existing state and local building codes. Additionally, the provision would apply only to low-slope roofs where the insulation is installed entirely above deck (a category that covers approximately 62% of existing commercial building floor space).

NRCA believes that this targeted proposal combining key components of H.R. 426 and H.R. 2615 is a highly credible short-term proposal for creating badly needed jobs in the construction industry, while also significantly improving the energy efficiency of the nation's building stock.

The Small Business Tax Relief and Job Growth Act

Like many other small businesses, NRCA members have experienced great difficulty in obtaining access to credit in the current economic environment. The scarcity of credit is a key factor in preventing entrepreneurs from starting or expanding small enterprises, which have been the key drivers of job growth in our economy in recent decades.

Given this situation, NRCA wants to commend Chairwoman Velazquez for introducing the Small Business Tax Relief and Job Growth Act (H.R. 4841). This legislation will help create jobs by providing tax relief that is targeted at starting or growing a small business. H.R. 4841 amends the Internal Revenue Code to increase the tax deduction for business start-up expenditures, allows expensing in 2010 and 2011 of improvements to real property and structural improvements to buildings used in a trade or business, including roofs, and would reduce the net capital gains tax of C corporations with annual gross revenues of $15 million or less from the current 35 percent to 15 percent.

One targeted measure that can help create jobs is an expansion of Section 179 expensing which allows small businesses to quickly recover the cost of business purchases. The Internal Revenue Code currently allows businesses to take an immediate deduction for property used in their trade or business, but the only types of property that are eligible are purchases of tangible personal property. H.R. 4841 expands Section 179 to allow

deductibility of structural improvements and improvements to real property, including improvements to roofs and other building components. Expanding the types of property that can be expensed under Section 179 promotes business productivity by lowering taxable income while also increasing purchasing power for small businesses.

H.R. 4841 would reduce the corporate capital gain rate for small corporations with less than $15 million in annual revenues from 35% to 15%. Many small businesses have appreciated assets, such as land and stock, which could be quickly sold to increase cash flow for the business in times of tight credit availability. A lower capital gains rate would greatly facilitate the sale of appreciated assets to generate the capital needed to create jobs. This provision is simple and straightforward, allowing small corporations to simply look at their own balance sheet and determine which appreciated assets to sell. This rate reduction creates increased cash flow for the small business to use for operations, expansion, or to maintain or hire new employees.

Finally, under current law, a taxpayer may only deduct up to $5,000 of the startup costs incurred when attempting to form a new business venture. Newly formed businesses rely on this deduction to increase cash flow early in the life of the business, a time when many small businesses are most vulnerable. H.R. 4841 increases the amount of the first year deduction from $5,000 to $20,000. This change would greatly assist small business start-ups in the construction industry and other sectors of the economy by providing greater levels of capital to be used to invest in the business. Expanding the availability of capital for new ventures will help entrepreneurs create new jobs as quickly as possible.

Conclusion

Again, NRCA urges Congress to address the alarming 25 percent unemployment rate in the construction industry by moving forward with targeted initiatives such as the Green Roofing Energy Efficiency Tax Act and the Small Business Tax Relief and Job Growth Act. NRCA looks forward to working with the members of the committee in this regard.

Thank you for your consideration of NRCA's views on these matters.

THE AMERICAN INSTITUTE OF ARCHITECTS

STATEMENT OF
CHRISTOPHER J. GREEN, AIA

"Tax Initiatives that Promote Small Business Growth"

United States House of Representatives
Committee on Small Business

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May 5, 2010
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Introduction

Madam Chairwoman Velazquez, Ranking Member Graves, and members of the Committee, I am Christopher J. Green, AIA, President of AGO Studios, a two-person architectural firm based in Avon, Colorado, and Vice Chairman of the Sustainable Building Technology Committee that developed the International Green Construction Code, the first-ever sustainable building code. I want to thank you for the opportunity to testify today on behalf of my firm and the American Institute of Architects (AIA).

The current economic crisis has affected every American, but, as this Committee knows all too well, it has hit small businesses like mine particularly hard. Moreover, the impact of this recession on the design and construction industry has been simply devastating. According to the U.S. Department of Labor, the unemployment rate in the construction industry in March 2010 was 24.9 percent, the highest by far in any industry.[1] The Associated General Contractors of America report that in the last year, 48 out of 50 states and the District of Columbia lost jobs in the construction industry.[2]

In my profession, the Labor Department reports that employment at architectural firms has dropped by 18 percent between 2008 and 2009.[3] And that is only counting those who have applied for unemployment insurance. Many of my colleagues report being underemployed or working without pay for as long as 18 months. That is an enormous burden for workers who have families to feed and mortgage bills to pay. Worse, many young architects are simply leaving the profession, looking for opportunities elsewhere. A dearth of young talent will hamper the ability of our country to get back to building once economic conditions improve.

Architects are, by and large, small businesspeople. In fact, 95 percent of architecture firms employ 50 or fewer people.[4] They are truly the engine that drives the design and construction industry. Architects are job catalysts – they are the first workers to be involved in the construction process when they develop designs. Hiring an architect leads to employment in other

[1] http://www.bls.gov/news.release/pdf/empsit.pdf
[2] http://www.agc.org/cs/news_media/press_room/press_release?pressrelease.id=568
[3] Bureau of Labor Statistics
[4] http://info.aia.org/aiarchitect/thisweek09/1009/1009b_firmsurvey.cfm

construction-related fields, from engineers and manufacturers, to steel and electrical contractors. In fact, there is one architectural service worker for every 34 construction industry workers in this country,[5] creating over $1 trillion in economic activity in 2008.[6] In fact, a recent study by the George Mason University Center for Regional Analysis found that every $1 million invested in design and construction creates 28.5 new full-time jobs.[7]

Architectural activity is a harbinger of construction work: the AIA Architecture Billings Index (ABI), which surveys work on the drawing boards, is a leading indicator of construction activity nine to 12 months down the line.[8] The most recent ABI, although showing more encouraging results than in recent months, still indicates less demand for architectural work than the month before. Indeed, the most recent issue of *Bloomberg/Business Week* magazine notes that the index has been contracting for 26 consecutive months. In other words, the decline in the industry has not turned around, but is merely slowing. This means that the construction industry should expect soft demand for its service for the next nine to 12 months. Clearly, we are not out of the woods yet.

Billings at my company are down 75 percent from a year ago. Construction starts are very few, primarily because clients are:

- Unable to get the necessary credit to help finance new construction or remodels. This is due to a series of conflicting banking policies that require higher levels of loan to value ratios, significantly higher levels of capital investment in a project, and revised pro forma statements that are affected by current levels of foreclosures, short sales, and other factors;
- Facing falling property values, along with new construction values that are being significantly affected by appraisals when compared to short-sale real estate transactions;
- Or municipalities that have cut back so heavily on budgets, personnel, and services that capital projects are not being considered unless absolutely necessary. In one instance in my home state, a municipal improvement project that was scheduled for last year was shelved because the company that had committed to provide financing for the project

[5] U.S. Department of Labor
[6] www.census.gov/const/C30/total.pdf
[7] www.naiop.org/foundation/contdev.pdf
[8] www.aia.org/aiaucmp/ groups/aia/documents/pdf/aias076074.pdf

pulled out because of market conditions. That project has not been re-scheduled, affecting a number of small businesses that were counting on it to increase the vibrancy of the town center this project would have fostered.

These problems are not unique to Colorado. They are being repeated in virtually every community across the country. That is why the AIA and its partners in the design and construction industry have worked hard to call on Congress and the Administration to enact polices that will stimulate and restore confidence in the United States economy. The AIA's *Rebuild and Renew Plan for Long-Term Prosperity* identifies policy objectives that will put architects and their allied professionals back to work designing and building our communities and laying the groundwork for future economic growth.[9] As our President, George Miller, FAIA, told the Good Jobs, Green Jobs National Conference yesterday, "Architects and the construction industry can make a major contribution to America's economic and environmental security. Our industry has the will to make that contribution. What we need are the tools."

Congress has taken some important steps over recent years to address these challenges. The American Recovery and Reinvestment Act of 2009 (ARRA), though by no means a silver bullet, is providing opportunities for work for a number of architects; in fact, the AIA's research shows that, as of March, one in four architecture firms have recorded billable hours from stimulus-funded projects.[10] In addition, Congress' enactment and subsequent extension of the $8,000 homebuyers tax credit has undoubtedly made a difference in that marketplace. Lastly, this Committee's efforts to extend Recovery Act provisions that provide access to financing through the 7(a) and 504 loan programs have been indispensable.

However there is much more to be done. As the ABI figures show, we are still at least a year away from having a healthy business environment in the design and construction industry. With that in mind, I would like to propose a number of tax-related policy initiatives that Congress should take – and one Congress should avoid – in order to help small businesses get back on their feet.

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[9] www.aia.org/advocacy/federal/AIAB081324
[10] www.aia.org/advocacy/AIAB082671

1. Extend and Expand Clean Energy Tax Incentives

Incentives for building energy efficiency and renewable energy projects are triple winners: they create jobs in the design and construction sector, they lower our nation's dependence on fossil fuels, and they help homeowners and businesses save money on energy bills. As Vice Chair of the Committee that developed the nation's first green construction code, I can see first-hand the possibilities in improving our built environment through measures that promote efficiency and the use of renewable sources of power.

That is why the AIA, along with a broad coalition of environmental, business, real estate, and design and construction groups, strongly supports H.R. 4226, the Expanding Building Efficiency Incentives Act of 2009, introduced by Reps. David Reichert (R-WA), Ron Kind (D-WA), Geoff Davis (R-KY), Earl Blumenauer (D-OR), Christopher Lee (R-NY), and Tom Periello (D-VA). This bipartisan legislation would extend and expand several important energy efficiency tax incentives for homes and commercial buildings.

In particular, the AIA has long backed expanding the Energy Efficient Commercial Buildings Tax Deduction (Section 179D). This deduction has made an enormous difference in the ability of commercial, institutional, and public building owners to finance construction and retrofit projects that achieve 50 percent energy savings over a 2001 baseline.

Because the provision allows for the deduction to be assigned to the designer of the energy efficient property in the case of a public building, many architects, engineers, and energy service companies have been able to take advantage of it to lower their tax burden. In fact, one accounting firm, Engineered Tax Services of Florida, has reported it has secured almost half a billion dollars in tax deductions for architecture firms in the last year alone – with nearly half going to firms with 50 or fewer employees. Think about that: greener buildings, lower energy costs, and money back in the pockets of small design firms.

This deduction has a proven track record. But it is clear that the economic downturn has precluded many commercial building owners from taking on green projects. Increasing the deduction from $1.80 per square foot to $3.00 per square foot will make the deduction more

attractive and help put designers and contractors back to work. For this reason, more than 80 organizations and companies have joined the AIA in sending a letter to Congressional leaders in support of this increase.[11]

In addition, enhancements to the Section 179D deduction would increase its impact. One such enhancement would be to allow nonprofit building owners to assign the deduction to the designer, similar to public building owners. Also, it has come to our attention that there is a technical issue relating to the ability of partnerships and S corporations to benefit from the assignment of the deduction in the case of public buildings. Guidance clarifying these rules would provide certainty to partnerships and S corporations, consistent with Congress' intent. We are happy to provide more details on both of these issues.

2. Extend and Expand Tax Incentives for Small Business

Small businesses are incubators and job creators; the simple truth is that no economic recovery will take place unless small businesses are at the leading edge of it. But at a time when credit is tight and loans are hard to come by, small firms are having trouble just keeping the lights on, much less expanding and hiring new workers.

As I indicated earlier, Congress has taken a number of important steps to provide liquidity to small businesses, but the challenges we face are much greater than the solutions offered so far. Therefore, I am very pleased that Chairwoman Velazquez has introduced H.R. 4841, the Small Business Tax Relief and Job Growth Act of 2010, which would help small businesses gain access to capital and create jobs.

As an architect, I am particularly pleased that the legislation would expand the scope of Section 179 to make deductible structural improvements and improvements to real property. This not only will help small businesses invest and grow, but will lead to the hiring of design and construction professionals. If Congress is serious about job creation and economic recovery, it will pass this legislation and send it to the President.

[11] http://www.efficientbuildings.org/PDFs/CBTD_MoC_Letter.pdf

3. Provide Relief to Small Business from the ARRA COBRA Subsidy

In addition to enacting legislation to expand or extend tax incentives, Congress can help small businesses address the effects of the recession in other ways.

ARRA created a subsidy to help defray the cost of COBRA insurance for unemployed workers. Under ARRA, the government picks up 65 percent of the tab. This provides significant relief for workers who have been laid off from their jobs, in that they only have to pay 35 percent of the premium.

However, there was a consequence of this provision that impacts businesses, particularly small ones. Employers are required to pay 100 percent of the benefits up front and then obtain reimbursement later from both the insurance company and the government (via a tax subsidy). This is a significant burden for small businesses that have already been forced to lay off employees, and it creates cash flow problems that could lead to additional layoffs. This is especially true because beneficiaries have 90 days to enroll in COBRA. Should they wait, employers must then pay for the full three months of benefits at one time.

Let me be clear: the COBRA subsidy program is a good program that the AIA supports and believes needs to continue for as long as this economic crisis persists. However, we recommend that the program be improved to ensure that beneficiaries continue receiving the benefit while not unduly burdening small businesses.

A current government program, the Health Coverage Tax Credit (HCTC) provides an advanceable credit for a portion of qualified health insurance premiums, including COBRA, purchased by taxpayers who meet certain qualifications. We believe that this program could be expanded to include individuals involuntarily terminated from small businesses.

This is how it would work: after recently terminated workers enrolled in COBRA, the existing HCTC infrastructure would be used to verify eligibility and invoice the beneficiary, who would in turn send their contribution (35 percent of the monthly premium) to the Treasury. The Treasury

would then send 100 percent of the premium directly to the beneficiary's health insurance plan, relieving the small business of its "middle-man" status.

The HCTC advance payment infrastructure is already in place and, as such, there would be limited costs in expanding its use for the COBRA subsidy. Additionally, this fix would ensure that people who have lost their jobs due to the recession get relief from COBRA costs, while helping businesses of all sizes begin to rebuild their practices, stimulate the economy, and eventually rehire workers. We urge Congress to adopt this plan.

4. Oppose Tax Increases That Unduly Affect Small Businesses

Lastly, I wish to bring to the Committee's attention a proposal that has recently emerged that would unduly burden many small companies right at the point when they are struggling to get back on their feet.

It has been reported that the Ways and Means Committee is seriously considering a proposal to significantly increase taxes paid by S corporation shareholders. Under current law, S corporation income is not directly taxed, but instead flows through to shareholders who are taxed at the individual level as ordinary income. Income flowing from the S corporation may be classified as either salary paid to shareholders or as earnings distributions. A shareholder who performs services as an employee of the S corporation is subject to payroll taxes on amounts received as salary, but does not pay payroll taxes on amounts received as earnings distribution.

Although the details of the proposal currently under consideration are unclear, it is my understanding that the proposal would expand the application of payroll taxes to active shareholders of S corporations "primarily" engaged in "the performance of services." I understand that there is concern that some S corporations misclassify salary compensation as earnings distributions in order to avoid paying payroll taxes. However, my fear is that the proposal will entrap millions of small business owners who are legitimately and correctly classifying salary and earnings distributions, with limited public policy benefit.

The S Corporation Association has written to Ways and Means Committee Chairman Sander Levin (D-MI) to express its concerns over this proposal, stating: "By targeting service sector S corporations, this proposal would increase taxes on small business owners who are fully complying with the law. It will add to the tax code's complexity by creating new categories of business activity that will have to be defined and litigated. And, by blurring the line between income from labor and income from capital, this proposal will set the stage for future increases in payroll taxes on more capital-intensive sectors such as manufacturing and agriculture." The AIA joined 14 other organizations in signing that letter.

We understand that part of the motivation for this proposal is to find ways to offset the loss of revenue of various tax incentives, including, possibly, the ones I outlined earlier. As a small businessperson, I know all too well the importance of balancing the books. I believe that Congress and the Administration need to make deficit reduction a top priority. However, I am concerned that increasing some taxes on small businesses at the same time you are lowering others will not only hamper economic recovery, but will add more complexity and uncertainty to the tax code.

Although this hearing is focused on tax issues, I wanted to reiterate the fact that access to credit is by far the largest issue facing our industry. SBA loans are absolutely vital, but many of the rules and regulations are too strict, preventing many businesses from qualifying. In addition, I believe that the amortization of loans should be changed from 20 to 30 years, which will help drive recovery by reducing businesses' debt burden.

In conclusion, I would like to thank Chairwoman Velazquez, Ranking Member Graves, and the members of this Committee for giving me the opportunity to testify before you today. I also commend you for your dedication over the last two years in raising awareness of the problems that small businesses face in this economy and your leadership in advancing legislation that helps small business drive the recovery. The challenges that we as small businesspeople face are serious, but so is our commitment to play a leading role in rebuilding and renewing our country.

Thank you.

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CONGRESSIONAL TESTIMONY

Small Businesses Face Steep Tax Hikes Unless Congress Acts Soon

Testimony before
Committee on Small Business
United States House of Representatives

May 5, 2010

Curtis S. Dubay
Senior Policy Analyst, Tax Policy
The Heritage Foundation

Small Businesses Face Steep Tax Hikes Unless Congress Acts Soon

Madame Chairwoman, Members of the Committee, thank you for the opportunity to testify on what can be done through federal tax policy to help small businesses. My name is Curtis Dubay. I am tax economist at The Heritage Foundation, a non-profit research organization based in Washington with over 650,000 members nationally and growing rapidly. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

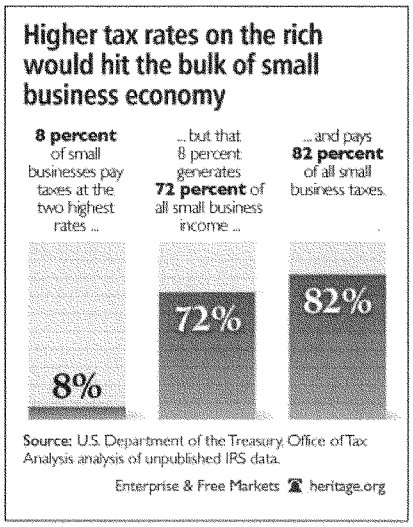
Many small businesses are struggling to survive as economic recovery remains slow. The primary focus of economic policy should be to improve the health of the overall economy. There is much the federal government can do in this regard, and mostly it involves allowing the recovery to continue without the threat of punitive new taxes and burdensome new regulations. Reducing the budget deficit solely through spending reductions would also benefit the overall economy by reducing the threat of a sovereign debt crisis here in the U.S. such as is now underway in Greece and threatening Portugal, Spain, and other countries. Eliminate these threats and small businesses will then thrive as the recovery quickens its pace.

There are far more types of small businesses engaged in more kinds of economic activity than Congress can devise special tax benefits to help. This sort of one-off, micro-managing, tinkering policy may gain a headline and support, but it will not help small businesses broadly. What they need first and foremost is lower tax rates. Therefore, it would be irresponsible for Congress to raise their tax rates now, but that is just what Congress is planning to do.

On January 1, 2011, the tax rates facing small businesses are set to jump, destroying jobs and lowering wages. The top two income tax rates now stand at 33 percent and 35 percent, but will rise to 36 percent and 39.6 percent. These increases will hit small businesses hard. A widely propagated myth contends that raising top tax rates has little effect on small businesses because only a small percentage of them pay rates at that level. But the number of businesses that pay top rates is economically meaningless because so many small businesses represent the part-time efforts of their owners. An economically meaningful measure shows that raising top income tax rates would slam the small businesses that contribute the most to our economy.

According to the Treasury Department and as shown in the chart below, 8 percent of small businesses pay the highest two tax rates. But those businesses earn 72 percent of all small business income and pay 82 percent of all income taxes paid by small businesses.[1]

[1] U.S. Department of Treasury, "Treasury Conference on Business Taxation and Global Competitiveness," July 23, 2007, p. 18, at */static/reportimages/E38CC2897AF3ECA865B6BF89138319B7.pdf* (May 3, 2010).



The small businesses that will pay higher taxes earn an overwhelming majority of small business income and employ most of the workers hired by small businesses. It is these businesses that the economy needs to create new jobs and ramp up economic growth after the severe recession. Higher tax rates would drain the businesses of cash flow, the lifeblood of any business, and would diminish the incentives to grow and add new workers.

Raising rates on these successful businesses would damage the economy at any time, but doing so now when the unemployment rate is starkly elevated and the recovery just underway is stunningly foolish.

Instead, at the very least President Obama and Congress should drop their plans to increase top tax rates on small businesses and make permanent the current-law tax rates for all taxpayers. This would eliminate yet another threat facing small businesses seeking to survive in some cases, in others to expand and add new jobs. This would be the best stimulus for the economy to date.

Lower Taxes on Capital Would Help Small Businesses

In addition to higher income tax rates, Congress is threatening to raise taxes on productive capital for small businesses. Capital is any resource that individuals or businesses use to create a good or provide a service. Like anything else, when the income accruing to capital is taxed, its user price rises and less of it is purchased. That means small businesses have less productive capability, grow slower, and pay lower wages. As such, taxes on capital should be minimal or nonexistent.

The current tax code taxes capital heavily. It taxes capital through the capital gains tax and taxes on dividends, both at 15 percent, and through taxes on business income and the corporate income tax—especially because businesses cannot deduct the full cost of the capital they buy, but must depreciate it over several years at a lower real value.

Under current law, the tax rate on capital gains will increase to 20 percent and that on dividends will increase to up to 39.6 percent on January 1, 2011. Congress should at the very least hold these rates at 15 percent. To lower the cost of capital for small businesses further, Congress should consider lowering the rate on capital gains and dividends below 15 percent and make permanent President Obama's plan to provide immediate small business expensing of all capital purchases.

Targeted Tax Cuts No Substitute for Low Rates

Many in Congress would prefer to offer targeted tax credits to specific small businesses instead of keeping income tax rates and taxes on capital low for all small businesses. But targeted tax cuts are no substitute. Targeted tax credits for small businesses that produce or sell certain items do not stimulate the economy or assist small businesses in general. They are corporate welfare for certain businesses that produce and sell goods that Congress deems beneficial.

When Congress provides tax breaks for only certain businesses it is picking economic winners and losers instead of allowing the marketplace—the traditional and wiser decision maker in such matters—to decide. It does so because the targeted tax credits give their recipients an advantage in the market compared to the businesses not fortunate enough to receive the tax break. The businesses that get the credit can keep their prices lower than they otherwise would without the credit.

Furthermore, in the current budgetary environment, since targeted tax cuts would be financed by adding to the deficit instead of reducing spending, the increased borrowing would take available funds away from other businesses. These other businesses could have used the funds to expand operations and add new jobs, but Congress will divert the resources to the businesses it prefers.

Congress should not be the arbiter of which businesses succeed and which do not. Its track record of making such choices is far from exemplary, and further efforts to move the market in the direction it desires could actually prevent breakthroughs that would benefit the economy and the United States.

The economy will recover eventually, and when it does the sales and profitability of small businesses will improve. At that time, targeted tax incentives will do nothing for the vast majority of small businesses that are ineligible to claim the tax breaks. For these businesses, and the economy as a whole, it is better to have low tax rates. That way, Congress is not influencing economic outcomes or engaging in corporate welfare, and small businesses have the proper incentives to expand operations, create jobs, and increase wages.

Resurrection of Death Tax Major Issue for Small Businesses

In addition to higher tax rates, small businesses may face higher death tax bills in the near future. The death tax expired for one year, beginning on January 1, 2010, and returns in full force on January 1, 2011. The death tax is a drag on America's small businesses, destroys jobs, and lowers wages while raising little revenue. As such, Congress should repeal the estate tax once and for all to remove an unfair burden from the backs of American small businesses and their workers.

When Congress passed the death tax in its modern form in 1916, it was supposed to prevent the buildup of wealth in a concentrated number of families and be a new source of revenue.[2] But in today's modern global market, the well-off are more likely to accumulate wealth by creating new and innovative products demanded by the expanding global market than through inheritance.

For instance, of the Americans in the top 25 of the *Forbes* list of billionaires, only those in the Walton family (Wal-Mart) inherited their fortunes.[3] The rest—including Bill Gates (no. 1), Warren Buffett (no. 2), Lawrence Ellison (no. 4), Michael Bloomberg (no. 17), and Michael Dell (no. 25)—earned their fortunes by taking risks and through innovation, business acumen, and hard work. Because wealth creation is so widespread, and not restricted to family lines or a lucky few that hit it big, the estate tax is largely irrelevant to ensuring a more equal distribution of wealth—assuming that was a defensible policy goal.

Despite the common misconception that the death tax impacts only wealthy estates, economists now generally agree that it is actually a tax on capital because of its impact on businesses and workers.[4] Capital—whether it is cash, equipment, or other types of property—is necessary for businesses to create new jobs and pay higher wages. There is a general consensus among economists that taxing capital is harmful to the economy.[5]

A recent study found that a full repeal of the death tax would create 1.5 million jobs.[6] This is half the number of jobs President Obama claimed the $800 billion stimulus package would create—at one-fifth the price.

Additional benefits from full repeal of the death tax include:

- Increasing small business capital by over $1.6 trillion;
- Increasing the probability of hiring by 8.6 percent;

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[2] See Darien B. Jacobson, Brian G. Raub, and Barry W. Johnson, "The Estate Tax: Ninety Years and Counting," *SOI Bulletin*, Summer 2007, p. 120, at *http://www.irs.gov/pub/irs-soi/ninetyestate.pdf* (November 6, 2009).
[3] Forbes, "The World's Billionaires," March 11, 2009, at *http://www.forbes.com/lists/2009/10/billionaires-2009-richest-people_The-Worlds-Billionaires_Rank.html* (November 6, 2009).
[4] See Robert Carroll *et al.*, "Personal Income Taxes and the Growth of Small Firms," National Bureau of Economic Research, October 2000, at *http://www.nber.org/papers/w7980* (November 9, 2009).
[5] See Kenneth L. Judd, "The Optimal Tax Rate for Capital Income Is Negative," National Bureau of Economic Research, April 1997, at *http://www.nber.org/tmp/87514-w6004.pdf* (November 12, 2009).
[6] Douglas Holtz-Eakin and Cameron T. Smith, "Changing Views of the Estate Tax: Implications for Legislative Options," American Family Business Institute, February 2009, at *http://www.nodeathtax.org/files/AFBF_Holtz_Eakin_2009.pdf* (November 6, 2009).

- Increasing payrolls by 2.6 percent;
- Expanding investment by 3 percent; and
- Slashing the current jobless rate by 0.9 percent.

The death tax also impedes economic growth because it stands opposed to the principles of virtue, thrift, and savings that made America the strongest nation on earth. For those Americans who think that their estates may one day pay federal death taxes, the death tax increases their incentive to consume their wealth today rather than invest and make more money in the future. Instead of putting their money in the hands of entrepreneurs or investing more in their own economic endeavors, Americans get the unmistakable message to consume it now.[7]

It is time for Congress to kill the death tax once and for all. Doing so would lift a tremendous weight off the shoulders of America's small businesses, create jobs for out-of-work Americans, and help the ailing economy.

Health Care Bill Adds New Burden on Small Businesses

Small businesses are not only dealing with potential damaging tax hikes, but now that President Obama has signed into law the Patient Protection and Affordable Care Act (PPACA) of 2010, small businesses can expect substantial tax increases in the near future. Combined, all of the tax increases in the PPACA (including those on employers that do not provide health insurance for their employees and on individuals who do not buy health insurance) will cost taxpayers $503 billion between 2010 and 2019.[8] Small businesses, their customers, and their workers will pay many of these higher taxes.

These tax hikes will slow economic growth, reduce employment, and suppress wages. By delaying the effective date for most of these new taxes, the President and Congress have shown themselves unwilling to implement these taxes on their own watch, raising doubts as to whether future Presidents and Congresses will be willing to do so. This increases even further the likelihood that this bill will substantially increase the deficit, which would break another Obama promise.

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[7] William W. Beach, "Seven Reasons Why Congress Should Repeal, Not Fix, the Death Tax," Heritage Foundation *WebMemo* No. 2688, November 9, 2009, at *http://www.heritage.org/Research/Taxes/wm2688.cfm*.

[8] Joint Committee on Taxation, "Estimated Revenue Effects of the Amendment in the Nature of a Substitute to H.R. 4872, the 'Reconciliation Act of 2010,' as Amended, in Combination with the Revenue Effects of H.R. 3590, the 'Patient Protection and Affordable Care Act ("PPACA"),' as Passed by the Senate, and Scheduled for Consideration by the House Committee on Rules on March 20, 2010," March 20, 2010, at *http://www.jct.gov/publications.html?func=startdown&id=3672* (April 5, 2010); Congressional Budget Office, Letter from Douglas W. Elmendorf, Director, to the Honorable Nancy Pelosi, Speaker, U.S. House of Representatives, March 20, 2010, at *http://www.cbo.gov/ftpdocs/113xx/doc11379/Manager'sAmendmenttoReconciliationProposal.pdf* (April 5, 2010).

The List of the Obamacare Taxes

Description of Tax	Year Effective	Revenue Raised (2010–2019)
Increase Hospital Insurance (HI) portion of the payroll tax from 2.9 percent to 3.8 percent for couples earning more than $250,000 a year ($200,000 for single filers).	2013	$210 billion
Apply the 3.8 percent HI tax to investment income for couples earning more than $250,000 a year ($200,000 for single filers) for the first time.	2013	*
Mandate for individuals to buy health insurance and employers to offer it to their workers.	2014	$65 billion
Annual fee on health insurance providers based on each individual company's share of the total market.	2014	$60 billion
40 percent excise tax on "Cadillac" health insurance for plans costing more than $10,200 for individuals and $27,500 for families.	2018	$32 billion
Impose an annual fee on manufacturers and importers of branded drugs based on each individual company's share of the total market.	2011	$27 billion
Exclusion of unprocessed fuels from the existing cellulosic biofuel producer credit.	2010	$24 billion
2.3 percent excise tax on manufacturers and importers of certain medical devices.	2013	$20 billion
Higher corporate taxes through stricter enforcement by requiring them to report more information on their business activities.	2012	$17 billion
Raise the 7.5 percent AGI floor on medical expenses deduction to 10 percent.	2013	$15 billion
Limit the amount taxpayers can deposit in flexible spending accounts (FSAs) to $2,500 a year.	2014	$13 billion
Reduce the number of medical products taxpayers can purchase using funds they put aside in health savings accounts (HSAs) and FSAs.	2011	$5 billion
Eliminate the corporate deduction for prescription expenses for retirees.	2013	$4.5 billion
Increase corporate taxes by making it more difficult for businesses to engage in business activities that reduce their tax liability.	2010	$4.5 billion
10 percent excise tax on indoor tanning services.	2010	$2.7 billion
Increased penalty for purchasing disallowed products with HSAs to 20 percent.	2011	$1.4 billion
Increase taxes on health insurance companies by limiting the amount of compensation paid to certain employees they can deduct from their taxes.	2013	$0.6 billion
Repeal special deduction for Blue Cross/Blue Shield organizations.	2010	$0.4 billion
TOTAL REVENUE RAISED		**$503 billion**

* Revenue raised from the application of the Hospital Insurance tax to investment income is included in the $210 billion figure shown above.

Sources: Heritage Foundation calculations based on data from the Joint Committee on Taxation.

Table 1 • B 2402 heritage.org

Bureaucratic Burden hurts Small Businesses

A little noticed provision added to the PPACA will burden small businesses with new paperwork:

> Under current law, businesses are required to issue 1099s in a limited set of situations, such as when paying outside consultants. The health care bill includes a vast expansion in this information reporting requirement. Businesses will now have to issue 1099s whenever they do more than $600 of business with another entity.[9]

Small businesses will now have to issue possibly billions of new forms to the IRS. While large businesses can absorb the cost of this new bureaucracy with their large legal and accounting teams, the new requirements will slam small businesses hard. The paperwork burden will force

[9] Chris Edwards, "Costly IRS Mandate Slipped into Health Bill," Cato at Liberty, April 26, 2010, at http://www.cato-at-liberty.org/2010/04/26/costly-irs-mandate-slipped-into-health-bill/ (May 3, 2010).

small businesses to redirect scarce resources from productive activities that could grow the business, add jobs, and pay higher wages to complying with the onerous new reporting requirements.

Tax Extenders Excuse to Raise Taxes Each Year

Each year about 45 tax provisions, collectively known as the "tax extenders," expire. These tax provisions, which apply to both individuals and businesses, include popular measures such as the research-and-development credit. Each year Congress must extend these laws to avoid tax increases on small businesses, hence their name "tax extenders."

Congress retains the tax extenders annually—but not before much hand-wringing about their supposed cost and even more haggling about paying for them with increases in other taxes. Congress should remember that continuing the tax extenders for another year is not a tax cut and that there is no need to pay for them with tax hikes.[10]

Congress should permanently extend all the expiring provisions it deems good tax policy and let the others expire. Congress should avoid any net tax hike, however, so for those provisions that it allows to expire, it should cut other taxes. Lowering marginal income tax rates would be the best course, since that would help spur the still-struggling economy[11] and it would directly help small business. The yearly threat of a tax hike ties the hands of many small businesses and holds them back from making important business decisions. A permanent extension of the tax extenders would provide stability for small businesses to plan for the future.

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[10] J. D. Foster and Stephen A. Keen, "Senate Tax Extenders: Another Sneaky Tax Hike," Heritage Foundation *WebMemo* No. 2006, July 30, 2008, at *http://www.heritage.org/Research/Taxes/wm2006.cfm*.

[11] J. D. Foster and William W. Beach, "Economic Recovery: How Best to End the Recession," Heritage Foundation *WebMemo* No. 2191, January 7, 2009, at *http://www.heritage.org/Research/Economy/wm2191.cfm*.

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I

111TH CONGRESS
2D SESSION

H. R. 4841

To amend the Internal Revenue Code of 1986 to provide tax relief for small businesses.

IN THE HOUSE OF REPRESENTATIVES

MARCH 12, 2010

Ms. VELÁZQUEZ introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1986 to provide tax relief for small businesses.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Small Business Tax Relief and Job Growth Act of 2010".

SEC. 2. INCREASE IN ALLOWABLE OF STARTUP EXPENDITURES.

(a) IN GENERAL.—Clause (ii) of section 195(b)(1)(A) of the Internal Revenue Code of 1986 is amended by striking "$5,000" and inserting "$20,000".

1 (b) EFFECTIVE DATE.—The amendments made by
2 this section shall apply to amounts paid or incurred in tax-
3 able years beginning after December 31, 2009.

4 **SEC. 3. INCLUSION OF CERTAIN IMPROVEMENTS AS SEC-**
5 **TION 179 PROPERTY.**

6 (a) IN GENERAL.—Subsection (d) of section 179 of
7 the Internal Revenue Code of 1986 is amended by adding
8 at the end the following new paragraph:

9 "(11) SPECIAL RULE FOR 2010 AND 2011.—For
10 purposes of this section—

11 "(A) IN GENERAL.—The term 'section 179
12 property' shall include any qualified improve-
13 ment to real property, or qualified structural
14 improvement, placed in service after December
15 31, 2009, and before January 1, 2012.

16 "(B) QUALIFIED IMPROVEMENTS TO REAL
17 PROPERTY.—For purposes of subparagraph
18 (A), the term 'improvements to real property'
19 means any improvement to a paved parking
20 area, wharve, dock, bridge, fence, retaining
21 wall, outdoor lighting, or other improvement
22 (other than to a building or its structural com-
23 ponents), intended to improve or make such
24 property ready for use in a trade or business.

"(C) QUALIFIED STRUCTURAL IMPROVEMENT.—For purposes of subparagraph (A), the term 'structural improvement' means any improvement to a building or its structural components (including improvements to the roof, drainage, plumbing, electrical components, heating, ventilation, or air conditioning, insulation, fire protection) intended to improve or make such building ready for use in a trade or business.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2009.

SEC. 4. REDUCE CORPORATE CAPITAL GAINS RATE FOR SMALL BUSINESS.

(a) IN GENERAL.—Section 1201 of the Internal Revenue Code of 1986 is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) SPECIAL RULE FOR QUALIFIED SMALL BUSINESS.—

"(1) IN GENERAL.—In the case of a qualified small business, subsection (a) shall be applied by substituting '15 percent' for '35 percent' each place it appears.

1 "(2) QUALIFIED SMALL BUSINESS.—For pur-
2 poses of this subsection, the term 'qualified small
3 business' with respect to any taxable year means a
4 corporation which, for 3 of the 5 immediately pre-
5 ceding taxable years—
6 "(A) was a C corporation, and
7 "(B) had average annual gross receipts of
8 not more than $15,000,000.
9 "(3) CONTROLLED GROUPS.—For purposes of
10 the paragraph (2), all corporations which are mem-
11 bers of the same controlled group of corporations
12 (within the meaning of section 1563(a)) shall be
13 treated as 1 corporation.".
14 (b) EFFECTIVE DATE.—The amendments made by
15 this section shall apply to taxable years beginning after
16 the date of the enactment of this Act.

○

May 5, 2010

The Honorable Nydia Velázquez
Chair
House Small Business Committee
2361 Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Sam Graves
Ranking Member
House Small Business Committee
B-363 Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairwoman Velázquez and Ranking Member Graves:

On behalf of Associated Builders and Contractors (ABC), a national organization with 77 chapters representing 25,000 merit shop construction and construction-related firms with 2 million employees, we appreciate the opportunity to share our concerns as they relate to the House Small Business Committee's hearing entitled, "Tax Incentives that Promote Small Business Growth." Under the nation's current tax system, rates are too high and laws are too complex, thus inhibiting the growth of small businesses. ABC strongly supports minimizing the tax burden on the construction industry to help increase the rate of capital formation, economic growth and job creation.

The construction industry has suffered the most acute impacts of the economic downturn. With a current unemployment rate of nearly 25 percent, the construction industry simply cannot continue to endure uncertainty in the business environment. During this time of economic recovery, meaningful tax relief that leads directly to job creation must be provided for small businesses.

Congressional legislative and federal regulatory anti-business proposals have created an environment of economic uncertainty in the business community that is negatively impacting the economic recovery of the construction industry. The ultimate impact of these proposals is unclear, which in turn has caused much uncertainty in the industry and has paralyzed many firms, not allowing them to adequately plan for the future. Currently, employers are unwilling to hire additional employees or invest in new equipment or facilities. ABC believes job creation in the construction industry is best fostered in a pro-business environment where free enterprise and open competition are unconstrained.

In order to break the construction industry out of the dire situation we are currently facing, ABC believes that the following issues also must be addressed immediately to promote small business growth:

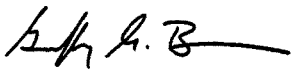
- Allow a 20 percent deduction for small business income;
- Reduce the Capital Gains tax rate;
- Repeal the Estate Tax;
- Repeal the individual and corporate Alternative Minimum Tax (AMT);
- Reduce the Payroll Tax;
- Extend the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements;
- Repeal 3 Percent Withholding Tax (Section 511);
- Support the use of the Completed Contract Method for small construction contractors;
- Exclude small construction contractors from the look-back accounting requirements;

4250 North Fairfax Drive, 9th Floor • Arlington, VA 22203 • 703.812.2000 • www.abc.org

- Provide tax relief for home-based businesses;
- Provide tax relief for the self-employed.

Small businesses are the backbone of our economy and give Americans a sense of pride and accomplishment in our country. In the construction industry, they provide valuable jobs and play an integral role in building communities. Lessening the tax burden on individuals and providing meaningful tax incentives will encourage small business owners and construction companies to reinvest in their businesses, thus expanding the economy. We look forward to working with you to provide tax incentives for small businesses.

Sincerely,



Geoffrey Burr
Vice President, Federal Affairs

Statement of

The Associated General Contractors of America

submitted to the

Committee on Small Business
U.S. House of Representatives

on the topic of

Tax Initiatives that Promote Small Business Growth

May 5, 2010

The Associated General Contractors of America (AGC) is the largest and oldest national construction trade association in the United States. AGC represents more than 33,000 firms, including 7,500 of America's leading general contractors, and over 12,500 specialty-contracting firms. More than 13,000 service providers and suppliers are associated with AGC through a nationwide network of chapters. Visit the AGC Web site at www.agc.org.

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
2300 Wilson Boulevard, Suite 400 • Arlington, VA 22201 • Phone: (703) 548-3118 • FAX: (703) 837-5407

The Associated General Contractors of America (AGC) is pleased to submit these comments for the record of the May 5, 2010 hearing of the House Small Business Committee entitled "Tax Initiatives that Promote Small Business Growth."

Introduction

The Associated General Contractors of America (AGC) is the largest and oldest national construction trade association in the United States. AGC represents more than 33,000 firms, including 7,500 of America's leading general contractors, and over 12,500 specialty-contracting firms. Over 13,000 service providers and suppliers are associated with AGC through a nationwide network of chapters. AGC contractors are engaged in the construction of the nation's commercial buildings and industrial facilities, highway and public transportation infrastructure, water and wastewater systems, flood control and navigation structures, defense installations, multi-family housing, and more. Small business is big in construction. In 2005, 92 percent of construction firms had fewer than 20 employees. Only 1 percent had 100 or more.

State of the Construction Industry

Continuing the momentum of economic recovery aided by the enactment of the American Reinvestment and Recovery Act (P.L. 111-5) ("Recovery Act") and subsequent legislation, is particularly important for the construction industry. Increases in public-sector construction spending, driven by Recovery Act funds, helped boost total construction activity by almost $2 billion between February and March 2010. The figures show that the Recovery Act has gone from slowing declines in construction spending to contributing to increases.

March U.S. Census Bureau figures show construction spending at an annualized rate of $847.3 billion, an increase of 0.2 percent from $845.5 in February. While private-sector construction spending still dominates the market, it declined 0.9 percent between February and March, from $555.7 billion to $550.8 billion. Public-sector construction, meanwhile, increased 2.3 percent from $289.9 billion to $296.5 billion during the same time frame due to significant increases attributable to the Recovery Act.

Despite these gains, increases in construction spending are unlikely to last once the Recovery Act runs its course. High office and retail vacancy rates, and underutilized capacity indicate that private-sector construction will continue to decline through at least the end of the year. Further, cash-strapped state and local governments are not expected to increase their capital programs until at least 2012. That is why AGC is urging Congress to move forward with multi-year reauthorizations of surface transportation, aviation, and water infrastructure programs to provide opportunities for the construction industry beyond the Recovery Act.

AGC has studied the economic impact of infrastructure investment on job creation. AGC's analysis, in partnership with George Mason University, showed that investment in nonresidential construction adds significantly to jobs, personal income, and Gross Domestic Product (GDP)—far beyond the hiring that takes place in the construction industry itself. AGC found that $1 billion in nonresidential construction spending would add about $2.6 billion to GDP, about $780 million to personal earnings, and create or sustain 28,500 jobs.

Despite the Recovery Act, national construction unemployment is at 21.8 percent, compared with the total private unemployment rate of 9.9 percent. The industry is in a critical, vulnerable stage in economic recovery, so maintaining program continuity is key to "staying the course" set by the infrastructure investment and tax provisions in the Recovery Act. This is particularly true for small businesses.

During consideration of the Recovery Act, AGC urged Congress to enact economic stimulus legislation that would have an immediate positive impact on economic activity. AGC's recommendations included both stimulus spending and targeted tax provisions to stimulate public and private investment in infrastructure and nonresidential construction, and to leverage stimulus funding by incentivizing capital investment. AGC continues to believe that targeted tax relief is an important component of the economic recovery package and makes the following observations regarding the impact of the tax provisions enacted in the Recovery Act and subsequent legislation, and additional recommendations for future tax relief.

Bonus Depreciation and Section 179 Expensing Levels

The Recovery Act extended a temporary benefit for businesses to recover the costs of capital expenditures made in 2008 faster than the ordinary depreciation schedule would allow by permitting these businesses to immediately write-off 50 percent of the cost of depreciable property (e.g., equipment). The Recovery Act extended this benefit for capital expenditures made in 2009. The Recovery Act also allows small business taxpayers to write-off up to $250,000 of capital expenditures subject to a phase-out once capital expenditures exceed $800,000 until the end of 2009.

AGC member construction companies are taking advantage of these provisions. In particular, smaller construction companies are making investment decisions (i.e., making purchases of equipment sooner rather than later) due to the enhanced Section 179 expensing. These results are consistent with a survey of contractors conducting in summer 2008 that found that approximately one-third of survey respondents said that they purchased equipment in the first half of 2008 to take advantage of the depreciation bonus and/or increased Section 179 expensing levels enacted in the Economic Stimulus Act of 2008 (P.L. 110-185). The survey also found that more than three-quarters of contractors would be more likely to buy additional equipment in 2009 if the depreciation bonus and the increased Section 179 expensing levels were extended. The reason cited most often by the survey respondents for why their companies had not take advantage of the incentives was that the economic slowdown had led to a considerable drop in construction work (and, therefore, the need for additional equipment). This concern continues and will likely remain until a six-year reauthorization of surface transportation programs is enacted.

While the depreciation bonus has had a positive impact on the economy and was an incentive for businesses that were able to make investments last year, due to a nuance in the tax code, the benefits of the law have been denied to long-term contractors (i.e., businesses that construct facilities or produce products under contracts that are not completed in the same year in which they are entered). In circumstances in which long-term contractors purchase equipment or other depreciable items for use in the performance of their contracts, the Internal Revenue Code's percentage-of-completion method of accounting (PCM) typically nullifies the beneficial effects of bonus depreciation. PCM requires revenues from long-term contracts to be taken into income in proportion to the project costs

that have been incurred to date. Since bonus depreciation accelerates costs for tax purposes, a corresponding percentage of revenue is accelerated under PCM. As a result, unless an adjustment is made in the bonus depreciation provision, contractors will be excluded from the benefits of the provision and will not be motivated to make purchases of new equipment that will generate near-term jobs in the equipment industry.

To build on the Recovery Act investments and spur capital expenditures, AGC recommends extending the bonus depreciation and increased Section 179 expensing levels for capital expenditures made in 2010. An adjustment to bonus depreciation must also be made so that long-term contractors are not excluded from the benefits of the provision.

5-Year Carryback of Net Operating Losses for Small Business

Under current law, net operating losses ("NOLs") may be carried back for the two taxable years before the year that the loss arises (the "NOL carryback period") and carried forward to each of the succeeding 20 taxable years after the year that the loss arises. For 2008, the Recovery Act extends the maximum NOL carryback period from two years to five years for small businesses with gross receipts of $15 million or less. The Worker, Homeownership, and Business Assistance Act of 2009 (P.L. 111-92) allowed all businesses of any size to elect to carry back net operating losses incurred in 2008 or 2009 (but not both) for up to five years.

The expanded NOL carryback provisions are helpful to contractors who were unprofitable in 2008 or 2009. However, contractors may become or continue to be unprofitable in 2010 based on industry projections for the construction market in the short term. Because capital to run operations (meet payroll, etc) continues to be very tight, if available at all, the need to convert a future tax benefit into cash today is critical to maintain cash-strapped but otherwise viable businesses. Such critical NOL relief would help construction companies, as well as businesses in other industries, save jobs, make critical investments, and in some cases, stay open for business.

AGC recommends extending the five-year carryback provisions for NOLs incurred in 2010.

Three Percent Withholding

Section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) mandates that federal, state, and local governments with total annual expenditures of $100 million or more withhold 3 percent from all payments for goods and services, including payments made to contractors for public works repair or construction. AGC strongly believes that this requirement should be repealed. If the 3 percent withholding law is not repealed, it will require a significant over-withholding of payments to construction companies that will cause an adverse impact on their cash flow, limit hiring opportunities, and will likely increase the price government entities pay for construction services. According to the Construction Financial Management Association's (CFMA) 2007 Construction Industry Annual Financial Survey, construction companies averaged 2.7 percent income before taxes on contracts. That means under Section 511 the government is withholding a percentage of taxes that is greater than the industry's average income before taxes.

Moreover, while the 3 percent withholding requirement is not set to go into effect until January 1, 2012, thanks to a one-year delay enacted in the Recovery Act, construction companies, as well as state, federal, and local governments, are expending funds starting to prepare for implementation now. These are needless preparation expenses, particularly during rough economic times. And, with construction companies facing narrower profit margins, the prospect of additional tax withholding diverts available resources away from business expansion activities, including workforce investment and equipment purchases.

AGC recommends an immediate and full repeal of the 3 percent withholding law. AGC supports H.R. 275, sponsored by Representatives Kendrick Meek and Wally Herger, which would repeal the 3 percent withholding law.

Multiemployer Pension Plans

The drop in the value of pension plan assets coupled with the current credit crunch has placed defined benefit plan sponsors in an untenable position. At a time when companies desperately need cash to keep their businesses afloat, the new defined benefit plan funding rules require huge, countercyclical contributions to their pension plans. Consequently, many companies will divert cash needed for current job retention, job creation, and needed business investments and instead be forced contribute the cash to their pension plans to fund long-term obligations.

Many AGC members—large and small—contribute to multiemployer defined benefit plans. AGC urges Congress to enact relief to moderate the effects of the aggressive funding targets contained in the Pension Protection Act (P.L. 109-280). Such relief is necessary to avert devastating burdens and job loses arising from massive contribution increases and unavoidable benefit reductions that would be required to comply with those rules.

AGC recommends the following:

1) providing additional time for plans that are financially challenged, but fundamentally sound
2) providing new financing approaches to help employers meet the increased contribution requirements for plans in critical or seriously endangered condition
3) strengthening the Pension Benefit Guarantee Corporation (PBGC) so that is has sufficient resources, direction, and authority to achieve its stated mission of promoting defined benefit plans and the security of participants' retirement income

AGC recommends that multiemployer pension plan funding relief be enacted to allow contributing employers to remain economically viable and to employ covered participants. Contributions attributable to such employment are critical to the long-term survival of those plans. AGC supports H.R. 3936, the Preserve Benefits and Jobs Act of 2009, sponsored by Representatives Earl Pomeroy and Patrick Tiberi.

Tax Extenders

On January 1, 2010 a number of key tax provisions for U.S. businesses expired. As a result, employers are operating without important tax incentives for research and development and capital improvements, as well as deductions for state and local sales taxes, among other costs. Congress has

yet to enact a "Tax Extenders" bill that would extend these critical incentives for U.S. businesses. Below are three expired incentives of benefit to the commercial construction industry.

1. 15—Year Depreciation for Leasehold Improvements, Retail Improvements, and Restaurant Improvements/New Construction. Before the economic downturn, the restaurant industry spent more than $10 billion in 2007 on construction of restaurant buildings. Restaurant industry construction spending alone created 280,000 jobs in the overall economy in 2007—an impressive figure that can and should be replicated with extension of the 15-year depreciation schedule.
2. Section 45G Short Line Rehabilitation Tax Credit. Over 500 short line railroads preserve nearly 50,000 miles of track that otherwise would have been abandoned by the large Class I railroads. This track received little investment by its previous Class I owners and must be upgraded if 13,000 rail customers are to stay connected to the national main line rail network. The Section 45G short line railroad rehabilitation tax credit is vital to the maintenance of this aspect of the nation's infrastructure, and is responsible for the creation of at least 6.9 million rail maintenance of way (MoW) work hours each year. On an annualized basis, this equates to 3,305 full time jobs nationwide.
3. Brownfields Expensing. There are hundreds of thousands of brownfields sites across the country, many located in urban areas. Restoration of these sites restores blighted areas and plays a key role in community development. The brownfields expensing tax provision is a critical part of encouraging this important environmental remediation work because it allows the costs to be deducted in the year in which they are incurred. Incentivizing brownfields cleanup creates jobs for the engineering and construction firms that engage in this work. The provision also paves the way for new businesses to be located in these primarily urban areas, creating jobs in places where unemployment is often high.

AGC supports H.R. 4213, the Tax Extenders Act, and urges Congress to enact the bill as soon as possible.

Estate Tax and Expiring Tax Provisions

In 2001, Congress attempted to repeal the estate tax and its harmful effects on family-owned businesses. Unfortunately, the 2001 law created great uncertainty about the future taxation of their businesses for construction owners considering a succession plan. The 2001 law phased the top estate tax rate down to 45 percent in 2009 and increased the tax exemption to $3.5 million, and repealed it completely in 2010. The estate tax is scheduled to be reinstated in 2011 at the higher pre-2001 levels. Currently, the estate tax rate is zero with modified carry-over basis in place. AGC supports permanent reform at the lowest possible rates and highest possible exemption levels (indexed to inflation) and reinstatement of stepped-up basis to alleviate business uncertainty and allow contractors to use resources that might otherwise go towards estate preparation or to pay the tax on growing their businesses for future generations.

Also in 2001, income tax rates were lowered by 3 percent, and those reductions, along with those for capital gains and dividends, are set to expire in 2011. For contractors, high income taxes—whether corporate or individual—reduce a company's cash flow, thereby reducing the amount of money available to these businesses to expand, buy equipment, hire more workers, bid on future projects,

and reduce debt. AGC supports lowering the federal tax burden on individuals, construction companies, and other businesses as a means of promoting investment, business development, and business expansion. High marginal tax rates inhibit entrepreneurial activity by penalizing successful businesses, especially the majority of AGC members organized as S Corporations, sole proprietorships, or partnerships that pay taxes at the individual rate. Because of the expiring tax cuts, construction companies face great uncertainty about the future taxation of their business, and this will hinder long-term investment strategies.

AGC recommends that Congress enact a permanent estate tax and continue the expiring tax rates to lower the federal tax burden on small businesses as a means of promoting investment, business development, and business expansion.

Construction Contract Accounting

The Tax Reform Act of 1986 revised the long-term contract accounting rules for contractors. These rules—contained in Section 460 of the Internal Revenue Code—place unfair burdens on construction contractors and should be modified in two ways: 1) to account for inflation grown since 1986; and 2) to provide relief from the onerous "lookback" accounting requirement.

In 1986, Congress enacted changes in Section 460 requiring contractors to use the percentage-of-completion method of accounting (PCM) for reporting taxable income from long-term contracts. Long-term contracts are contracts that are not completed within the tax year in which they are entered into. PCM requires contractors to calculate what percentage of the contract is complete in a tax year and then pay taxes on that percentage. Congress created an exception to Section 460 for smaller contractors. Those contractors whose contracts will be completed within two years of the contract commencement date, and whose average annual gross receipts for the preceding three tax years do not exceed $10 million are exempt. Unfortunately, the $10 million threshold was not indexed for inflation. Today, more and more small contractors are crossing the threshold and are being forced into the burdensome and costly percentage of completion method.

AGC recommends that the $10 million exemption be updated to $25 million to account for inflation since 1986.

In addition, the 1986 Tax Act enacted a provision mandating the use of the lookback method for all long-term contracts accounted for on the percentage-of-completion method of accounting. The lookback method requires a construction contractor to file amended tax returns for every prior year in which a currently completed contract was in progress. The difference between the theoretical taxes that would have been due if all the facts were known in the year the contract was entered into, and the taxes actually paid in prior years, is calculated. Interest is then calculated on this change in prior-year tax liabilities. Lookback does not result in a change of a contractor's tax; it does not require contractors to pay more, or less, in taxes. It does, however, require a contractor to pay or receive interest, and to spend thousands of dollars on tax practitioners to make the interest calculations.

The lookback method is exceedingly complex, and imposes compliance and administrative burdens on construction contractors, which diverts valuable time, labor, and resources of construction financial

and accounting professionals from worthwhile functions. The lookback method poses special problems for smaller contractors that have to hire outside accounting experts to calculate lookback.

The Taxpayer Relief Act of 1997 attempted to address this issue by providing an election to forego application of the lookback method if the estimated gross profit recognized in each contract falls within 10 percent of the retroactively determined gross profit for year the contract was in progress. However, this provision provides no relief from the paperwork burden. That is because election to apply this provision requires most of the above calculations, as well as additional calculations in order to determine whether each contract falls within this 10 percent variance in each prior year.

AGC recommends that Section 460 be modified to exempt construction contracts of 36 months or less in duration from the lookback filing requirement.

Diesel Retrofit

AGC members are making efforts to reduce the impact of off-road diesel-powered construction equipment on the environment. One way is by retrofitting their equipment. However, for the construction industry, the costs of retrofitting equipment are prohibitive without financial assistance. AGC urges Congress to provide financial and technical assistance to construction equipment owners and operators to encourage these firms to install emissions control technologies on their diesel engines or, in some cases, to offset the cost of a replacement engine or an entirely new piece of equipment. Congress can provide this assistance by fully funding EPA's Diesel Emissions Reduction Program and by enacting provisions in the surface transportation reauthorization bill that would provide federal funding to contractors engaged in federal-aid highway and transit projects for diesel retrofit activities.

In addition to grant funding, AGC recommends a 30 percent investment tax credit to construction equipment owners, as well as manufacturers, to spur investment in cleaner, more fuel efficient off-road diesel-powered construction equipment.

Energy Efficient Commercial Building Tax Deduction

Current law allows owners to deduct the cost of installing energy efficient systems, like new heating and cooling units, in commercial buildings. The amount of the deduction is up to $1.80 per square foot that will see at least a 50 percent efficiency improvement. Given the limited impact this deduction has had on boosting energy efficient installations, Congress should raise the deduction amount to $3.00 per square foot, and consider converting the tax benefit into a tax credit, for an extra incentive.

AGC supports H.R. 4226, the Expanding Building Efficiency Incentives Act of 2009, sponsored by Representative Dave Reichert.

Conclusion

AGC members are ready to build, to create and sustain jobs throughout the country. Construction has always been an engine of economic stimulus and can play that role once again. While increases in infrastructure investment do have a direct impact on the economy, at the same time, AGC members,

most of which are small businesses, have benefited from the tax provisions enacted in the Recovery Act and subsequent legislation. However, these benefits are limited. That is why AGC also makes recommendations to improve bonus depreciation, extend tax incentives that support construction activity, allow NOL relief to all businesses through 2010, and provide some relief from pension plan obligations, 3 percent withholding taxes, and burdensome construction contract accounting rules, while also extending the 2001 and 2003 expiring tax relief provisions for small businesses.

Thank you for this opportunity to comment.

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