S. HRG. 113–283

SMALL BUSINESS TAX REFORM: MAKING THE TAX CODE WORK FOR ENTREPRENEURS AND STARTUPS

ROUNDTABLE

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

JULY 17, 2013

Printed for the Committee on Small Business and Entrepreneurship

Available via the World Wide Web: http://www.fdsys.gov

U.S. GOVERNMENT PRINTING OFFICE

87–580 PDF WASHINGTON : 2014

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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SMALL BUSINESS TAX REFORM: MAKING THE TAX CODE WORK FOR ENTREPRENEURS AND STARTUPS

WEDNESDAY, JULY 17, 2013

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS
AND ENTREPRENEURSHIP,
Washington, DC.

The committee met, pursuant to notice, at 3:08 p.m., in Room 428, Russell Senate Office Building, Hon. Mary L. Landrieu (chair of the committee) presiding.

Present: Senators Landrieu, Shaheen, Risch, Scott, and Enzi.

OPENING STATEMENT OF HON. MARY L. LANDRIEU, CHAIR, AND A U.S. SENATOR FROM LOUISIANA

Chair LANDRIEU. Good afternoon, everyone. Welcome to our roundtable on Small Business Tax Reform: How to Make the Tax Code Work for Entrepreneurs and Startups. I really appreciate the members joining me for this roundtable this afternoon.

As the title indicates, the topic is extremely important. The venue is a little less formal than a regular hearing and we specifically wanted this subject to be considered in a roundtable format so we could encourage a lot of back-and-forth discussion and free, open dialogue. Of course, any written statements will be submitted for the record but this is a roundtable and the title suggests informality. A lot more informal.

I am going to start with a short opening statement, and then turn to my Ranking Member for a short opening statement. Of course, we will recognize members as they join us. They may not be able to stay through the whole two hours but I will, of course, recognize them.

But, then we are going to go through a series of questions and comments and have a free flow of information which I find very, very helpful; as it helps us to build a record on the subject of tax reform that we can then move to the Finance Committee.

I want to say to begin with that I am very happy that three members of the Small Business Committee are senior members of the Finance Committee. Senator Enzi. So thank you, Senator, for joining us today. Senator Cantwell, who may be joining us later, and has submitted some questions and statements for the record. And, Senator Cardin who we are expecting today.

So, we have got three members; and for many years my Ranking Member, Senator Snowe, who is no longer here but served as a member of the Finance Committee and had lot of impact on small business tax policies.

Senator Risch and I are happy for you all to join us. Let me just begin with a brief statement. I thank you for being an important part of this debate, and being a part of this roundtable. I thank especially those of you that traveled all the way from the West Coast. It is a long way to come to Washington but we do want to hear views, of course, outside of the Beltway and from the West Coast.

I am pleased to welcome so many small business owners, investors, and experts. We have experts from Louisiana, Idaho, South Carolina and all the way from California, again a very strong, wide spectrum of small business owners; and this Committee has been and will continue to be the place for your voices to be heard here in Congress.

As many of you know, last month the Senate Finance Committee Chair, Senator Baucus, and Ranking Member Hatch sent a letter to all Senators requesting ideas and our partnership in the effort to get tax reform over the finish line.

There are few matters more important to small businesses in America than the taxes that they pay and the records they are required to keep to support their filings. In-line with this Committee's long tradition of working to enlighten and inform the Senate on matters of concern to small business from immigration to health care to other important issues, this roundtable is designed to get your views on tax reform.

I am looking forward to hearing from all of our participants and, of course, we will share the record if this roundtable with the Finance Committee, and they are well aware of our hearing today.

In addition to ideas of how we can simplify the tax code, I also want to hear if you all agree or disagree with the three principles of tax reform laid out in the letter from the Chairman and Ranking Member of Finance to us; and also Rep. David Camp expressed these ideas in a Wall Street Journal op-ed on April 8.

The first principle of tax reform this bipartisan leadership group identified is to protect the middle class and ensure taxes are not increased for working or middle class families.

The second principle of tax reform they outlined is to level the playing field for U.S. employers to ensure tax reform makes U.S. companies more competitive in the global economy.

The third principle they are committed to pursuing in tax reform and the one most relevant to our discussion today is parity for small business, to ensure that any tax reform plan does as much to help start up businesses create jobs, family businesses to be created, sustained, and grow as desired and compete as equally on that level playing field with large companies, whether privately or publicly owned, whether domestic or international.

Are there other principles that you all would like us to consider as we move forward, and if so, what are they?

Some discussion topics we are going to talk about today are do you agree or disagree with the principles outlined, do you have other suggestions, are there new and innovative ideas that you can throw on the table to accelerate startups, or increase angel investment that we should know about? What would a new reformed tax code designed to help American small business to employ more people and grow look like?

In addition to the overall complexity of the tax code, are there specific provisions that seem particularly unfair and burdensome to you that you would like to jettison or to moderate or modify?

So again, I am going to turn this over to my Ranking Member. I thank him for his participation and hopefully he can stay through most of the meeting today and I would be happy to turn the mike over to Senator Risch.

OPENING STATEMENT OF HON. JAMES E. RISCH, RANKING MEMBER, AND A U.S. SENATOR FROM IDAHO

Senator RISCH. Thank you, Madam Chairman. We are making progress here. Usually you get to make a long opening statement and then you turn it over to me for a short opening statement. So, it sounds like we are on parity now.

Chair LANDRIEU. That is great.

Senator RISCH. Wonderful.

Thanks all, and I want to thank all of you for coming today on what is a serious subject and something that is important obviously for those of us who are members of the Small Business Committee.

I preach here all the time that the biggest problem that faces small business in America today is the Federal Government and the regulatory structure that it heaps on small businesses day after day after day. Obviously, the tax code is one of the most serious offenders, so we want to hear what you have to say about that.

We are interested in that and we will hopefully have some substantial input as the Finance Committee writes a new tax code. We are aware, of course, that most small businesses are pass-through entities, and we are going to insist that be considered as tax reform goes forward.

I have to warn you that there are people here in the Congress who do not look at this necessarily as an opportunity to help you, but rather to help themselves; that is, they want to do tax reform so that they can extricate more money out of small businesses.

And, a number of us are going to insist that it be revenue neutral, that is, that it not be the situation where they do tax reform and at the end of the day small businesses say "Oh, look, the Federal Government got another trillion dollars." So, we are going to be watching that as we go forward.

So again, I thank all of you for coming. I know being small business people it is difficult to get away from your businesses so we appreciate that. We understand it, and thank you, Madam Chairman.

Chair LANDRIEU. Thank you very much. As a tradition of our roundtables, I would like everyone to go around and just introduce themselves very briefly and provide literally 30 seconds about what makes you excited to be here today. We will start with you, Kristie. You have got to speak right into your mic. It is a little difficult and make sure your button is pressed.

Ms. ARSLAN. Sure. Thank you for having me. I am Kristie Arslan. I am the president of the National Association for the Self-Employed, and I am also a small business owner. My husband and

I are new business owners. We own a gourmet popcorn company in Alexandria, Virginia that has been open for about 15 months.

So, the NASE represents America's smallest businesses, the self-employed and micro businesses, those with 10 or fewer employees; and so obviously tax reform is a very big concern because the tax code either hinders people from starting a business or is their top priority.

Chair LANDRIEU. How many members do you all have?

Ms. ARSLAN. We have 150,000 member businesses.

Chair LANDRIEU. Great.

Ms. ARSLAN. There are 22 million self-employed Americans nationwide.

Chair LANDRIEU. Mr. Canty.

Mr. CANTY. Good afternoon. My name is Kenneth Canty. I am the President and CEO of Freeland Construction Company, headquartered out of Charleston, South Carolina, and also with offices here in Bethesda and at Bowie.

I am excited to be here to have somebody actually listen to our concerns and our frustrations regarding in the tax code and how burdensome it is too small businesses.

Chair LANDRIEU. And your Senator wanted to welcome you personally and I would like to call on him now.

Senator Scott.

OPENING STATEMENT OF HON. TIM SCOTT, A U.S. SENATOR FROM SOUTH CAROLINA

Senator SCOTT. Thank you, Madam Chairwoman.

One of the things that excites me about having Kenneth with us here today is that not only—you want the microphone on really. Okay. We will do it your way then.

[Laughter.]

One of the things I find exciting about having Mr. Canty, Kenneth, here with us today is the fact that not only is he a small business owner but his track to a small business ownership is so consistent with the story of the American dream.

Mr. Canty was a leader of a demolition project on one of the largest projects South Carolina's history, the replacement of the Cooper River Bridge, the now infamous Ravenel Bridge in South Carolina, a $750 million project.

He was working very hard on that project. At the end of that project, he got laid off; and like many people do when they find themselves in dire straits when they are laid off from a position, they decide, they scratch their head, pull their hair out and they make the decision to—it is gone now, he did a good job—they make the decision to go forward and start a business.

Mr. Canty was in a position where in 2008 he was able to successfully acquire a business and he has grown that contracting business from $1 million to $10 million in sales, gross sales from 2008 to 2013. So, just in five short years he has had tremendous success.

But, we ask ourselves, and I asked him as well, what is the secret sauce; and he says you have to be diligent. You have to be on the marketing trail all the time.

I said, well, what are the impediments to your success? And certainly, he named a number of things. The tax code happens to be one of the impediments to his success.

So, as we hear from Mr. Canty and other small business owners, not only today but into the future, we will find very consistently that the question of whether or not the tax code encourages success, encourages risk-taking or not his a simple answer. The answer is no. The tax code is an impediment to it.

I think Mr. Canty's example and his story is one that we all share as small business owners. We are so happy to see your success as small minority businesses from South Carolina are rarer than they should be and your success is quite amazing. Thank you

Chair LANDRIEU. Thank you. Let us continue the introductions.

Mr. ECKERT. My name is Mike Eckert. I am Vice Chairman of the Angel Capital Association. I am an entrepreneur. I have started three businesses. I am now a very active angel investor, limited partner venture capital funds, invest heavily. I live in New Orleans, invest heavily in New Orleans and in the Atlanta marketplace.

Our concern relative to tax policy is ensuring that certain incentives are available to angel investors which are the primary funding source of startup companies and small businesses in America.

Chair LANDRIEU. Thank you so much.

Mr. Edwards.

Mr. EDWARDS. I am Chris Edwards, Director of Tax Policy Studies at the CATO Institute, and I am honored to be here today and particularly honored to be amongst all of these great entrepreneurs.

When I think of entrepreneurs and the tax code, I think of capital gains taxes and I have been very concerned that we have recently raised our federal capital gains tax rate from 15 up to 24 percent. If you had state and local taxes on top of that, you get a U.S. long-term capital gains rate of about 28 percent.

The average rate in the OECD countries, the high income countries, is only 16. So, other countries have figured out that there are a lot of good reasons to keep capital gains tax rates low, and one of them is is the importance of capital gains for the funding of high-growth entrepreneurial companies. I think we need to keep that in mind.

Thank you.

Chair LANDRIEU. Thank you.

Mr. Hodge.

Mr. HODGE. Thank you, Madam Chairman.

My name is Scott Hodge and I am President of the Tax Foundation. The Tax Foundation is one of the Nation's oldest tax research groups. We spend our energies looking at the economics of taxation, trying to make sure that tax reform is done right, not just the arithmetic of tax reform but the economics of tax reform.

I think it would be a shame to have a simpler tax code that actually leads to higher capital costs and slower economic growth.

So, the real idea here is to have a tax system, a new tax system, that is conducive to long-term economic growth, not just for small businesses but all businesses and all Americans.

That should be the goal. We should be very careful in how we get there because there are lots of ways in which we can streamline the tax system, broaden the tax base, but a lot of those ways will actually harm economic growth not improve it.

So, we need lower rates but we also need lower costs of capital and less regulations that make it easier on small businesses to thrive and grow.

Chair LANDRIEU. Thank you.

Mr. Keeling.

Mr. KEELING. Thank you. I am Michael Keeling, President of The ESOP Association, and I am excited to be here because I get to show you something.

You can see this chart I hold up. There is a red bar and there is a blue bar. The general social survey shows that during the great recession conventionally-owned companies laid off employees at a rate of over 12 percent—the red bar. Employee stock-owned companies laid off employees at a rate of 2.6 percent—the blue bar.

We hear people talk jobs, jobs, jobs, jobs. Our nation has a policy that lets people keep their jobs, pay taxes, pay Social Security, pay Medicare taxes; and that policy is what I am excited about. The policy is in the tax code and we need to keep the policy encouraging employee ownership and perhaps expand it.

A sidebar: This little green book I hold up is a transcript of a hearing the Small Business Committee of the Senate held on February 27, 1979 on employee ownership.

Chair LANDRIEU. Great. I am glad we are following in such good stead all these years.

Go ahead, Ms. Nellen.

Ms. NELLEN. I am Annette Nellen, a tax Professor at San Jose State University. I am pleased to be here to talk about one of my favorite topics, tax reform. For many years I have been a tax professor with the last 10 plus years focused on tax reform and how we can have tax reform that follows principles of good tax policy and modernizes our tax system.

I would be pleased to talk about that when we get into the conversation. Thank you.

Chair LANDRIEU. Great.

Is it Mr. Nelson and I think you wanted, Senator, to do the honors.

Senator RISCH. Yes, thank you. I want to introduce Greg Nelson, who is the General Manager of Brown Rental, Incorporated, and about to become the owner of Brown Rental Incorporated, at least a substantial portion of it.

First of all, Mr. Nelson has owned other companies and is now looking forward to taking on part of this company. Brown Rental has been around for a long, long time. They are a classic small business operation.

Essentially they rent construction tools and other types of equipment to the community. It is really a poster child for small business in America. I am sure that Greg will be happy to enlighten us on his thoughts on tax reform. Thank you.

Mr. NELSON. Thank you very much. I am glad to be here. Yeah, what Senator Risch was saying kind of continue with that. I have grown up in Idaho my whole life. I have had two businesses that I did successfully and sold. I am in my third adventure now.

Some of the problems that I do see right now is a lot of the tax issues that I am dealing with. I am having to hire people to interpret it. I am having to have accountants kind of go through. I am in the middle of SBA right now and that is real difficult for just a regular business guy out there. I have to run my business, I work in the business, and now I am having to learn a whole new part or side of the business and that is difficult for me.

I have kind of name that some of the unintentional consequences that role downhill to me. What happens up here it seems like sometimes it, it makes sense on paper up here but by the time it gets to me, man alive, it is tough.

Chair LANDRIEU. Great.

Mr. NELSON. It is.

Chair LANDRIEU. Thank you so much.

Mr. NELSON. You bet.

Chair LANDRIEU. Next.

Mr. RANDOLPH. Thank you for inviting me. I am Bill Randolph. I am here from the Treasury Department. I direct the Business and International Taxation, Office of Tax Policy. I am an economist.

I am actually very excited to be here to hear especially from people, business people outside the Beltway who know the problems that small businesses face. We are very well aware that small businesses face a very unduly complex tax code and face a disproportionate share of complying with that code; and we really are happy to take part in discussions about tax reform that can try to make the tax system simpler for small businesses and also increase the incentives for investors in new startups and try to take, try to make it so that businesses can spend more time on their business and less time on, you know, reading the tax code.

Chair LANDRIEU. Thank you.

Ms. Sullivan.

Ms. SULLIVAN. Hi, I am Ann Sullivan. I am representing Women Impacting Public Policy. WIPP represents a million women business owners across the country and has 71 organizations in the coalition.

I am excited to be here today because the thought of simplifying the tax code and making it fairer is something that is very attractive to the folks that I work with.

Chair LANDRIEU. Thank you.

Mr. Zinman.

Mr. ZINMAN. Thank you for inviting me to participate today. I am the Tax Policy Chair of the National Conference of CPA Practitioners, NCPAP. NCPAP members serve over 1 million businesses and individuals throughout the country.

We are the professional acting as the CFOs for those small businesses. We clarify confusing rules in the tax code, answer questions about employment and sales taxes.

Small business owners often pay a disproportionate amount for legal and tax services. They rely on outside advisers to ensure that they are receiving the benefits of available tax credits while guaranteeing they are following the tax code regulations.

Small business owners want to healthy economy. Tax incentives to help them grow their businesses, a tax code that is understandable, and a government that allows them to succeed.

Thank you.

Chair LANDRIEU. Excellent. Senator Enzi, as you know, is a member of the Finance Committee, and we would like him to say a word, and I really appreciate his help and attendance today.

Senator ENZI. Thank you, Madam Chairman. I appreciate being on this Committee and its emphasis on small business. I have been on it ever since I came to Washington, and it does make a difference.

Of course, I also enjoy being on the Finance Committee. I am looking forward to some real tax reform, and we have to do the corporate and the individual at the same time so that the pass-through corporations are not left at a disadvantage.

I go home to Wyoming almost every weekend and travel a different part of the State so I get to know as many of my folks as I can, and I always try to get into a small business because if there is a small business that you have not worked in, it will look pretty simple; but when you get to talk to the people that are having to make those decisions on a daily basis, you find out that the simple decisions are really pretty complicated and affect a lot of people and have an ever widening circle of people that they affect.

I once held a small business hearing in Wyoming courtesy of this Committee and I thought the room was pretty well packed but afterwards the media came up to me and they said, gee, not many people showed up, did they. I said, well, I am in small business and you know in small businesses if they have enough people to send them to something like this, they got too many people so they will get rid of them.

[Laughter.]

So, I appreciate having some expertise. I appreciate that you are doing a roundtable for this. That is an opportunity for everybody, hopefully a short bursts, to talk about pet peeves or pet solutions or that sort of thing, and then even have an interaction between the panelists. I find that it really works well.

The current tax code does not work and I have reintroduced some different portions of bills that I think will help. One of them is logical tax return date schedules. I have got some bipartisan support on this side of the Hill for it and on the other side it has already round up in a bill. That will help to make the filing a lot easier.

Besides being a former small business owner, I am an accountant. I love the numbers and I know that the current tax code is too complex. It is causing a domino affect of problems. It can be simpler. It can be fairer, and I think it is imperative that we reform both codes at the same time, and I just cannot thank the Chairman enough for having this roundtable so that we can learn a few more things from the people who are actually having to work with it.

So, thank you for being here.

Chair LANDRIEU. Thank you all very much. I would like to recognize Senator Shaheen who has joined us and also to notify—do you want to say anything?

Senator SHAHEEN. No.

Chair LANDRIEU. Okay. And to notify everyone we may have a vote that is called, but we are going to work through the vote and we will just come and go to vote and make sure that we get our votes in on time. They may call the vote in the next few minutes but we are going to continue forward with our roundtable.

Now, this is how this works. You have a placard in front of you. When you want to speak, it is very simple. You do not have to raise your hand. You can just put your placard up. Try to turn the name to me so that I can see it and recognize you. Please jump in and offer your suggestions.

I am going to kick it off with a couple of questions; and I would love to start, if I could, with Mike Eckert, who represents the angel investors.

I was very, very taken in with your statement, Mike, that in 2012 angel investors invested $23 billion in approximately 67,000 early stage companies, and that angel investors provide seed stage equity at any rate that is 20 times higher than the number of companies financed by venture capital.

I am not sure that people in Washington know that. I did not know it. I am happy to know it. So, can you elaborate on that and say how the tax code either encourages or discourages that and what are some of your ideas about what we should be thinking about.

I do know that getting capital into the hands of the small businesses that need it is essential, and I do know, because every roundtable we have had has had people up here saying if I could just get my hands on some capital, I could grow my business; and so, we really are pushing that very hard through our Committee.

So, why do we not begin with you.

Mr. ECKERT. Thank you, Madam Chairman. The Angel Capital Association——

Chair LANDRIEU. Try to lean into your mic. I am sorry it is a little awkward.

Mr. ECKERT. Is this better?

Chair LANDRIEU. Yes, better.

Mr. ECKERT. 200 member groups that are populated by about 10,000 angel investors who are all accredited investors. They write individual checks. This $23 billion is a real number. It came from individuals throughout the country. The angel investors provided about 90 percent of the capital to start up companies in America.

Right now one thing that benefits angel investors who are generally high net worth individuals is incentives. It keeps them in the game. Angel investing is a very high risk investment class. Fifty percent of the deals in which we invest fail. Our objective is to keep people in the game and even send them.

The hundred percent exemption from capital gains tax has been very, very important in keeping angel investors investing. That tax provision is due to sunset at the end of this year. We really are hoping that that can be made permanent.

There are also two facets of Section 1202 that we are talking about here. The current holding period is five years. We are hoping that it can be reduced to two years because the dynamics of exiting investments for angels has been reduced. The IPO market is over.

We are seeing a lot of larger companies come in and acquire the smaller companies that we have started and that we mentor and coach and grow exiting sooner. We think that five years may not be as practical.

We also think that another facet of Section 1202 should be adjusted. Currently, Section 1202 only contemplates C Corporations. In many of the deals in which angel investors invest are LLCs, limited liability companies, and we would love to see those included in Section 1202's exemption.

We are very worried that, if Section 1202 is not extended, that we are going to see hundreds and maybe thousands of angels fall out of the system which will preclude capital for a lot of the people like these in this room who are starting companies.

Chair LANDRIEU. I would like someone else to comment on this particularly the CPAs. Go ahead.

Mr. ZINMAN. I would be happy to.

Chair LANDRIEU. And anybody that wants to speak just put your placard up.

Mr. ZINMAN. As Mike was speaking, I wrote down a quick note that what I found over the years is the biggest problem for getting money from a bank is you cannot get it if you need it; and generally the small businesses, even with the SBA, are having problems, especially post the recession.

There are a lot of businesses, a lot of individuals who put their houses up to mortgage so that they can finance their businesses and keep it going through the recession. Well, now they have come to the end of the rope. It is potentially a successful business but they need just that small extra infusion in capital. And, because of banking regulations possibly, because of conservativism, the small business owners do have to go and are happy to go to the angel investors because those are the ones that are able to make this happen.

Chair LANDRIEU. And can I—go ahead, Ann, I am going to get you in but let me ask something and you all just jump in here if you have any comments.

But, one question comes to mind. How do, Sandy, some of the people that you help know about angel investors and how do your angel investors know about small businesses? I am assuming you have a online network sort of like eHarmony.com or something like that.

Mr. ZINMAN. Well, I will let you answer that question because you are better at it. My answer is we tried to network a lot. We spent a lot of time networking because we become the voice of the small business. But I will let you answer that. You are even better than me at that.

Mr. ECKERT. Thank you, Sandy, but I thought your answer was pretty good as well.

Most angel investing occurs on a local basis. So, in the different markets in which I invest we are looking at local businesses to help create jobs, create companies in our local communities.

Once an angel group is formed, entrepreneurs will find us; and we will also hold events to attract entrepreneurs to make them aware of what we do, the investment criteria that our groups require as we determine whether we are going to invest in a deal or not.

So, it is not difficult for an angel investor, I mean, for an entrepreneur to find an angel investor; but also we angel investors want them to find us because we are seeking those kinds of investments.

Chair LANDRIEU. Ms. Nellen and then Ann.

Ms. NELLEN. I think it is a great equity point being raised here, equity in terms of treating people similarly. With 1202 I think it should be expanded to cover more than just an investment in a C Corporation.

And then there are other provisions. We hope everything goes well, but there is also, for example, a Section 1244 provision that only applies for a C Corporation investment and that would allow for, if things do not go so well, up to $100,000 of an ordinary loss. That should be expanded to other types of entities besides just C Corporations. There are a few rules that should be broadened beyond just C Corporations for equity purposes.

Chair LANDRIEU. Ms. Sullivan.

Ms. SULLIVAN. Women have understood the importance of family and friends and more organized investors like angel investors for a long time.

We have supported legislation to give them a big tax credit I would say 10 years ago because that is where women get a lot of their money. I would say the way that our members find them is mostly through organizations like WIPP or other organizations rather than individually. They look to their associations to help them find you.

Chair LANDRIEU. Mr. Hodge, I want to ask you that—go ahead, Mr. Edwards, and then I have a question for Mr. Hodge.

Mr. EDWARDS. The point about Section 1202, I noticed the Kauffman Foundation did a study recently about the importance of expanding Section 1202, extending the 100 percent exemption under Section 1202; and they tried to model exactly the economic impact of that.

What has always struck me about angel investment, entrepreneurs, and the high growth companies in the United States is that it is very difficult for any economist to model the impact of an Apple or an Amazon or a Facebook.

Some of these companies that have got angel and VC investment, they are hugely important for innovation. Almost all new innovation, if you look over the last century in the United States, has been pioneered by new companies, not existing ones.

So, you know, IBM did not invent the PC. It was new companies like Apple and Microsoft that pioneered it. So, in thinking about angel and venture capital entrepreneurs, we have to think about the long term. We need to think about the next generation of these usually important companies.

Chair LANDRIEU. I think that is an excellent point.

Mr. Hodge, I wanted to ask you on your point that you made in your opening about making sure the focus is not only simplification but amplification of the economic power of entrepreneurship or business start ups.

Do you want to add anything?

Mr. HODGE. Well, there are kind of two elements of it. One is the overall tax rate, and right now entrepreneurs are facing a higher tax rate than the largest corporations in America. As you know, the U.S. has the highest corporate tax rate in the industrialized world at 35 percent; but many of our pass-through businesses are paying a tax rate of over 40 percent.

Those high tax rates are called success taxes, and they are a tax on our most successful businesses, and that is simply not only unfair but it is also bad economics.

There is a second level of this is that as we try to lower the corporate tax or all the tax rates through tax simplification, we have to be careful about how we broaden the tax base; and there are some key elements here such as 179 expensing, accelerated depreciation, and other things that not only help us identify what is taxable income but also help us identify what is the tax base and lower the cost of capital.

And, if we move away from these things toward longer depreciation lives, even while we are lowering tax rates, we can increase the cost of capital and that undermines the economic growth that you achieve through lower rates; and we have modeled this with our macroeconomic model; and we have found that even if you lower rates and move toward longer depreciation lives, you actually neutralize the economic benefits that you get from a lower rate.

Chair LANDRIEU. You know, there is a lot of talk up here about lowering the corporate tax rate. The President has even endorsed such an idea and there are Republicans and Democrats who support that.

But when you lower the corporate tax rate, does that do anything specifically for small businesses generally?

Mr. HODGE. Well, you have to be careful again in how you get that and how you broaden the base because the majority——

Chair LANDRIEU. I am just talking about lowering the corporate tax. That in itself if you just lowered it does not really target small business, does it? It is the larger corporations.

Mr. HODGE. But it helps the broader economy. It adds about two percent to GDP and that helps all businesses.

Chair LANDRIEU. Sandy.

Mr. ZINMAN. So many of these small businesses are LLCs, S Corporations, partnerships; and in fact, Mr. Hodge is absolutely right, you need Section 179, but these individuals and if you take it up to the Northeast, they are paying in excess of 50 percent when they get hit with the AMT, when they get hit with the state and local taxes.

To the extent that sometimes, and I think it is counterproductive, some individuals want to find a business that is losing money because they can save some tax money. That is not a good reason to go into business. You should be going into business to make money; and when you are paying 50 percent, if you are putting in a lot of sweat equity, there is a disincentive to be making money.

Chair LANDRIEU. Excellent. Ms. Arslan.

Ms. ARSLAN. Yes. You know, obviously I think tax rates, especially for the self-employed, are very important. Our members are also proprietors, LLCs, partnerships but I cannot, you know, do not want to——

Chair LANDRIEU. If you speak into your mic.

Ms. ARSLAN. I do not want to de-emphasize the importance of compliance and simplification because one of the biggest barriers or what stops people in their tracks from starting their businesses is the overwhelming burden of how am I going to figure this all out. So, you know, we can lower the rates, but if it is not simple, it is still going to prohibit people from starting businesses.

And, I think in terms of corporate tax reform I think business, even our small businesses, the self-employed, see business as an ecosystem; and it is the reason why we think any kind of reform needs to be done together because healthy big businesses will help small business.

You know, a lot of our members contract with larger companies, corporations. So, if they are not in a good financial state, and we saw that with the recent recession, they cut their contractors; and a lot of our members were hit by that.

And so, we want a healthy corporate environment as well; but it cannot be done separately. It has to be done together so all business benefits from comprehensive tax reform.

Chair LANDRIEU. I think that is an excellent point, and I think sometimes we do not think about that. We think in terms of big versus small or small versus big; but the fact is it makes up the ecosystem; and the healthier everyone is and the better it really helps to create that synergy that is important.

Go ahead, Mr. Canty.

Mr. CANTY. Yes, I would like to just address the topic of what lowering the corporate tax, how that could effectively affect a small business.

I own a construction company, and the thing that runs a construction company is bonding. Everybody is probably pretty familiar with that, and typically five to ten percent of your net worth is what your bonding level will be. So, if you have $10 million of bonding, you need to have usually $500,000 to $1 million of net worth.

Well, every time you go to pay, if you make money one year and let us say you are paying, you have to send a check in, to make the math easy, for $50,000 in taxes, that comes right out of your retained earnings.

So, the bonding company can go back and look at you and decrease your bonding limit at that present moment when you pay those taxes in April. What else happens in April?

Well, if you are a federal contractor, typically that is the time when your federal contracts are flowing the slowest. Usually around the springtime it tends to be a little bit slow until the summer time, and the Congress sets their budget and the contracting officers start putting out work.

So, it is really a double whammy. So, when you pay those taxes on money as an owner that you really never, ever put it in your pocket, it is coming out of your retained earnings and affecting you negatively.

Chair LANDRIEU. So, what you are saying is if there would be a way to have a different timing on the taxes that are owed quarterly, particularly that quarter, that would be the second quarter of the year? Or?

Mr. CANTY. I would say that as a short-term but really what I would say—I guess as of this conversation goes it is appropriate to say this—is going away from, going away from the tax code we have now to more of a consumption-based tax code, because as a small business I am going to keep growing and growing and growing whether it is by the size of my company of geographically, and the more consumption I have maybe instead of the more profit I make the more consumption I have; and that goes back to the argument of spreading the base. The more we consume, our tax code should be based on that, from my viewpoint.

Chair LANDRIEU. No, and this is exactly appropriate to speak about that. That is what you want to talk about is you would rather have a consumption tax than a tax on your income.

Mr. CANTY. Yes, ma'am.

Chair LANDRIEU. So, it is the tax on the income as well as the timing.

Senator Enzi, this must be familiar to you. Can you add any wisdom? I am sure this is what you all talk about or I hope this is what you talk about in the Finance Committee. I do not know since I am not on it but I am hoping that this is what you are talking about.

Senator ENZI. Well, you have been doing a marvelous job with the questions. I can give you a little bit of relief I think with perhaps asking a couple of questions.

There are some expiring tax provisions, and we seem to hold businesses hostage with those on a regular basis. Are there any expiring tax provisions that add uncertainty to what any of you or your associations are doing that you would like to suggest that they be put on a longer basis? Yes.

Ms. ARSLAN. All of them, but largely, you know, based on what our members are saying what really is frustrating and hurtful to their business is Congress's inability to create long-term tax policy and it has just gotten worse.

It has gone from, we will extend this provision for two years to a year, to six months, to three months. It is really hindering small business' ability to plan. It is actually affecting our members, based on our polling data, and it is affecting their sales, especially when they do business to business, business to business customers.

So, that is really the larger issue. Obviously for our members, big deductions or things like the start up deduction expired, but the ability to deduct your health care costs if you are self-employed as a business expense, depreciation expensing, all of those items are key but just the fact that Congress is doing it so piecemeal and for such short a period of time that we have to ramp up for another battle on these tax provisions, every few months has been a big challenge for business owners.

Chair LANDRIEU. Mr. Nelson.

Mr. NELSON. Yeah, I just kind of wanted to finish off what Kristie is saying. I am not a member of hers but I am like that. I am that guy.

Right now I am going through and buying a business, and the amount of work just going through the SBA put on is ridiculous, I think. It is just hours of just reports and numbers and things like that; and I understand you have to have them but the in depth that we are going through is amazing to me.

It seems a little bit over the top. One of the other things that would help me would be definitely to simplify our tax codes because again I have to hire people to go out and interpret it for me and tell me if I am compliant and tell me if it is right.

And, I am not that type of person. I would rather do it myself but I cannot understand it and I do not have the time to get into it to understand it.

Another thing that would help, especially in my industry, is the Ways and Means Committee Chairman Camp has put together a bill for Section 179. What that does for us is help when I am buying equipment right now. I am trying to project what my next couple of years are going to be out there for the SBA.

But there is no consistency. Like Kristie was saying, taxes change every year. They changed in 2006. They changed in 2008. It has changed in 2009. It has changed again. And so, SBA is asking me to put together five years, and three to five years, and a changing tax code makes it real difficult.

So, at that point now I am hiring another person to help me do something. To get my SBA loan put together, I am hiring four people basically to help me put this together.

Representative Camp has put a proposal, and it is not in the numbers that I would like to see, but it would work for us. It would be great because it levels the playing field for us and I know where I am at for the next couple of years down the road, and to me that seems like that would be a very important thing to have happen is to get that section of 179 put through just for me as a small business guy out there.

I have talked to a few other people in my neighborhood and they are in the same boat. It is too hard to predict what is going on right now and give us any type of projection.

So, I think getting that Section 179 made permanent would make a real big difference in my business. It helps me know where my capital is, how much capital I will have. I will be able to buy more equipment than I usually can which I can use for doing more jobs, hiring more people, growing from the grass up. That is kind of where I am coming from on that.

Senator SHAHEEN. Thank you. I know Senator Enzi had another question that he wanted to ask but let me just follow-up on what you have said.

Senator ENZI. I better go vote.

Senator SHAHEEN. Yes, you better.

Senator ENZI. I will be back.

Senator SHAHEEN. Eighty percent of all of the paperwork that is done by small businesses is around tax compliance. So, it is no wonder that everybody feels this burden because it is real; and in the past 10 years alone there have been more than 4400 changes to the tax code. So, that is about one day for the last 10 years.

So, clearly this is something that we need to address as part of any tax reform I think is to simplify the tax code.

So, Mr. Edwards, let me call on you next.

Mr. EDWARDS. Two quick points to follow up on what Mr. Nelson said. There is this data out there that show that tax compliance costs for small business are much larger as a share of assets or whatever compared to large business; but what always strikes me listing to entrepreneurs is that it is the headache costs which are unquantifiable that are really important.

Large corporations can go and they can hire a lot of more accountants and stuff and the CEO can remain focused on investments and the big picture stuff.

For the entrepreneur, it is the paperwork costs, the tax cost, the health care compliance costs. Those are real headache costs that sap their strength to do what they should be doing which is, you know, building a better company.

The second thing I would point out, and Senator Enzi mentioned are expiring provisions. I think this Section 179 expensing is really important as is expensing in general.

The issue with capital investment, it seems to me, is that when companies go out and they buy new equipment, they are not just replacing the same equipment they had with the same new equipment.

Capital investment incorporates new innovations. When companies go out and buy new machines, they buy better, faster, more high tech machines than they had before. So, capital investment and innovation are really the same things.

I often see discussions about the R and D tax credit with respect to innovation, and that is fine and that is important. But, capital investment is very important for large and small businesses to move them ahead technologically.

Senator SHAHEEN. Thank you. Mr. Hodge, then Ms. Nellen and Mr. Eckert.

Mr. HODGE. Thank you. I would like to amplify a couple of the points that have been made here in particular on the compliance side and then on the expensing issue.

The SBA in 2011 issued a report trying to estimate the compliance costs of the tax system for small business pass-throughs in general, and they found out the total cost or estimated the total cost at about $52 billion a year for pass-through businesses.

And, if you think about that in economic terms, it is the equivalent of adding a couple of percentage points to the top marginal rate. If you could monetize that and capture that, you could actually cut the top marginal rate on small businesses by a couple of percentage points and that would do them all the better.

On the issue of expensing which Chris mentioned, unfortunately Congress has treated expensing as a stimulus plan rather than long-term tax policy; and the unfortunate thing is that expensing is viewed by the Joint Committee on Taxation as a revenue loss for the Treasury when, in fact, it is critically important for lowering the cost of capital and improving long-term economic growth.

We actually modeled this and that is in terms of making expensing permanent, and we found that over the long-term not only would it increase GDP by about two percent, it would actually pay for itself in increased federal tax revenues.

It is a good deal for the economy. It is a good deal for the Treasury, and unfortunately we are treating it as temporary and we keep trying to renew it each and every year which undermines the benefit of it.

Senator SHAHEEN. Right.

Mr. HODGE. As Mr. Nelson has found, it adds a tremendous amount of headache for small businesses.

Senator SHAHEEN. Can I just ask you? Is that a report that is recent and is it something that you can share with the committee?

Mr. HODGE. We would be delighted to certainly.

Senator SHAHEEN. That would be great.

Mr. HODGE. Sure.

Senator SHAHEEN. Ms. Nellen.

Ms. NELLEN. In addition to the temporary measure which makes it difficult to plan, the additional problem is a lot of times they do not get renewed until very late in the year.

For example, CPAs may have been telling their clients, you know, the 50 percent bonus depreciation is going to expire; the higher 179 amount is going to expire; you better get something before the end of the year, only to find out the last day of the year that it got renewed which causes tremendous problems regarding trying to budget, trying to plan, puts the CPA in a bad position.

So, that is another unfortunate part of temporary provisions besides the one mentioned here. It's that they often get renewed so late in the game.

Senator SHAHEEN. Mr. Eckert.

Mr. ECKERT. From the angel investor perspective beyond extending the hundred percent exclusion on capital gains which we spoke to earlier, what we hear from the companies in which we invest as many of us sit on boards of these companies or advised them and it relates to some of the things that you are hearing from the business people here, one general theme is certainty.

Things are just so uncertain that they have difficulty planning their businesses, and that is a particular challenge for them.

The other is related to what Mr. Nelson said. Many of them complain about the bureaucracy and paperwork burden related to these things because what these entrepreneurs are good at is their business, their market, whatever they make or sell or the services they provide; and they are not good at this stuff and they incur costs and time and that time takes them away from operating their business which in turn has a negative ripple impact on their business.

So, it is not necessarily the law of unintended consequences. Everybody knows that, but it really is a fact that it impacts these entrepreneurs heavily. We see it everyday.

Senator SHAHEEN. You know, I certainly could not agree more and I would bet that that is the sentiment on the part of everyone on this Committee, and what I hear from businesses, many businesses in New Hampshire, is, you know, we can live with whatever you do, just tell us what it is going to be so we are not dealing with it at the 11th hour that we do not know how to plan.

I believe one of the most important things we could do here in Washington is to come up with a long-term budget agreement that does provide some certainty for folks and that does include tax reform as part of that.

So, I could not agree more with what you are saying.

Now, Mr. Canty, Ms. Sullivan, and Mr. Zinman.

Mr. CANTY. One of the things we were just talking about was the time it takes small business owners to make sure they abide by the law.

I think this is something probably everybody on this Committee but particulate Mr. Nelson would understand is I spend a lot of my time trying to make sure I comply with the law so it takes me away from other things I could be doing, and I am paying my CPA to make sure everything is correct.

Now, if the tax law, code was different one might say, well, that means you are going to be putting the CPA out of business. I said no, because I am going to be using him for something else as I grow to plan and everything else.

But, the most insidious part of the whole thing is if I even unintentionally messed up my taxes or not pay or do something, I could go to federal prison.

I am held at the point of a gun to pay these taxes essentially to comply with it when I could be spending my time growing my business. I have grown my company from four people, we were at 33 at the end of last year. Because of sequestration, we backed down to 25.

I could spend my time figuring out how to employ people at 60, 70,000, $80,000 a year so that is one family that could be self-sufficient.

I would rather spend my time doing that as well as other people on this Committee than worry about, I think that they said the tax code is actually thicker than the bible. I need to spend my time worrying about how to grow my business, not how to pay my taxes.

Senator SHAHEEN. I know that the two of you want to comment on this discussion. What can I ask a question as well? That is, you talked about, I think, Mr. Nelson, you talked about the importance of making the expensing provisions permanent.

Are there other provisions in the tax code that you think would be helpful to small business in terms of increasing innovation and improving your ability to grow your business?

Ms. Sullivan, I do not know if you want to comment on that or you want to comment on the other discussions but please feel free to do either.

Ms. SULLIVAN. I just wanted to say that I am a little disheartened by the fact that we are jumping into discussions of "do you like the current Section 179 expensing" because women business owners see this as an opportunity to get rid of all of those tax breaks. We have polled them and the majority keeps on saying "just give us a lower tax rate. You can have all the rest of the deductions and credits."

We care about the cash. We care about the money in our pocket. So, we can all sit here and talk about the 20 small business tax credits and deductions, all of which serve a purpose if you are talking about the current tax system. But, I guess we were kind of hoping that the Congress was serious about dialing it back.

The other part that is really troublesome for businesses is just the formation of business and the complexity of forming them. We have to go to a CPA to figure out what formation our company ought to be, whether it should be a C, an S, an LLC. There are so many forms of business that you can choose.

It seems to us that if you are thinking about simplifying the tax code, you might simplify the way you think about forming them.

And then, one extra point was Senator Landrieu's question: does lowering the corporate tax rate have any effect on small business. I think the numbers show somewhere between 15 and 19 percent of all C Corporations are small businesses.

In fact, I have my own company and I am a C Corporation. There are those of us who are "C's" but there are not very many. That is a pretty low number.

So, you are really not doing much if you are just thinking about lowering the C Corporation rate. We go back to the principle, business is business, right? Why does it matter if you are self-employed, a C, S, I mean, why should it matter? You should have a standard set rate. You should have the same rules, and that is really what we are hoping a redo of the tax code could achieve.

Senator RISCH. You know, what she said brings up more discouraging thoughts about what is going to happen with tax reform. One of the things that surprised me when I got here, not much has surprised me, but one of the things that surprised me when I got here is how members of Congress have lost sight of the purpose of the federal tax code.

The federal tax code is meant to raise sufficient money to do the limited things that the Founding Fathers thought that a Federal Government should do. But, instead of that, what it has become is a social engineering tool.

There are 535 members of the Congress and lots and lots and lots of them think that they know a lot better what you should be doing than you. As a result of that, they put things in the code that either encourage you to do things like buy an electric car because they think you should be driving an electric car, or to punish you for doing things that they think that you should not be doing. There are all kinds of examples of this.

But, the federal tax code, as long as it continues to be used as a social engineering tool, is going to be the mess that it is today; and every time they pass something like that, the law of unintended consequences, which my experience tells me is present in every single bill that passes, comes right around and bites you when you do not want to get bit.

Senator SHAHEEN. Mr. Zinman.

Mr. ZINMAN. I just want to tag on two quick things in the discussion that has gone around. First is the idea of permanence, that we fix the tax code.

Honestly, every time the discussion on the Hill goes on about reforming taxes, I make more money, because everybody turns to me and says just check the law and the changes that they make. Make it permanent. Let me do my business the right way.

The other point that I want to emphasize, writing tax law is sort of like comedy. Timing is everything. A good law written in February can be a good law. If it is written in December and we have learned of this, is going to be God-awful.

And, it is so important to enact the rule at a time when people can understand. The IRS can give guidance. Maybe there are some tax cases that will come down the pike and we understand what is going on. Rather than relying on computers to churn out numbers really quickly, we need people to understand the law, to develop the law and it does take time to do that.

Senator SHAHEEN. Thank you. I do not know who was first but Mr. Edwards and then Ms. Nellen.

Mr. EDWARDS. Just a quick comment to amplify a couple of points that Senator Risch made. You know, it is interesting you say that because you look back the night in 1980 last big tax reform 1986, there was general agreement leading up to that tax reform to get rid of a lot of the loopholes and use the money to lower the rates.

The majority leader, Dick Gephardt, wrote an essay for the CATO Institute at the time. It could have been written by, you know, a sort of an extreme libertarian. It was a fantastic piece.

He said all the social engineering in the code is ridiculous. We need to get rid of it. Use the money to lower the rates. So, I think back in the 1980s there was more of a general agreement that that is where we ought to be going. Have a revenue neutral bill, get rid of a lot of the loopholes.

The other thing I would note about——

Senator RISCH. You know, that is gone today. I mean, you never hear anybody here complain about that at all.

Mr. EDWARDS. Right.

Senator RISCH. It is never even discussed. It is just, well, we can make people do this if we just tax them this way or give them this credit.

Mr. EDWARDS. Right, right.

The other thing I would point out about that is that a lot of these scandals that have happened in the tax code most famously with Enron were caused, it seems to me, substantially by the use by corporations that are bending the rules on the special provisions that were supposed to be for something but the corporations have combined all of these different elements that were supposed to incentivize certain people and mix them up in a big stew and come up with this, you know, this financial engineering that was what Congress never intended.

So, the social engineering is not just bad from an economic efficiency point of view, it is also bad in terms of, you know, corruption and scandal on the part of businesses cheating, it seems to me.

Senator SHAHEEN. Go ahead.

Senator RISCH. You know, there is a poster child for that right now. I sat here and watched people pass tax incentives to build windmills in order to generate electricity.

Well, you know, from an economic standpoint that is ridiculous. I mean, you are talking 24 cents compared to four cents for traditional ways of making electricity, but by golly the people here insisted they were going to force Americans to use green power and they were going to have them build the windmills.

So, the way to do it is to give tax incentives for people to build windmills. Well, lo and behold, people went out and took advantage of the tax code and companies like General Electric Corporation paid no taxes. Why? Because they took advantage of the law that this Congress passed.

And the exact same people who were saying, "By golly we need this tax incentive to go out and build these windmills," are now complaining that these rich corporations are not paying taxes. Well, who did they expect were going to build the windmills, you know, people without any money that did not pay taxes? Does not make sense. But anyway that is a perfect example of exactly what you are talking about there.

Senator SHAHEEN. I think there are probably a lot of other loopholes in the tax code that allowed GE to not pay any taxes but I do think that that is one of the challenges that I hear from small business in New Hampshire because they say, look, we have got these big corporations that are not paying any taxes because they can afford to have 2- and 300 lawyers and I have got, you know, my five or 10 or 20 employees and I cannot afford to have that kind of scrutiny of my taxes and so I am paying my fair share and other people are not, and I think it really does contribute to frustration that people have about the tax code.

Ms. NELLEN.

Ms. NELLEN. On both these items, what should be made permanent and also on the tax expenditures, a couple of things that have come up is one on 179 I think that should be made permanent for the certainty.

It is labeled as a tax expenditure; but as Mr. Hodge noted, when you talk about depreciation, there is an additional inflation, interest factors that are not being weighed into that.

So, that is the way a tax expenditure is. It is something that is certainly needed to measure net income. What are we going to do with the fixed assets we get, what kind of write-off, is it an immediate write-off, or depreciation. But it is not honestly always a tax expenditure because you are going to have to, I mean, as opposed to giving some extra credits for, you know, a windmill, this is something you need to measure net income.

179 should be made permanent, but I think it also needs to be updated. It focuses on tangible property. There is a temporary provision that has allowed software to be written off but today companies could be buying a variety of intangibles including just buying a business where one of the assets today is going to be a domain name. That is an intangible asset that would not fall under 179 today.

But, to really make it simple, modernize it, 179 should cover all tangible and intangible, personal property purchased by a business. And, whether that is a tax expenditure could be questionable as opposed to something that is just, you know, some bonus you are getting, but that one actually is obviously to measure your net income.

One other one that for some small businesses would be important would be the research credit. Now, is that just a giveaway? There are some other elements of some expenditures you are going to need to look at because a research credit has recognized some spillover effect that when the person is incurring the R and D there are benefits also being achieved from that by other companies that did not have to invest in it.

And, the competitive pressure unfortunately to not have a research credit when most countries do, it does factor into decisionmaking maybe not so much always for small business but certainly for medium to larger businesses. The research credit does not work probably as effectively today as it should because it has always been a temporary provision in the law.

But, those would be two I think of for innovation, 179 and the research credit, but probably not in their current form.

Senator RISCH. I would think that the research credit you are going to have trouble getting rid of. I mean, that is, as you point out there are legitimate deductions, not tax expenditures. These are legitimate deductions. A legitimate deduction is a cost of doing business.

We have Micron Technology in Boise, Idaho, and I guarantee you if they did not have a full-time, robust R & D enterprise in the basement turning out new things to make, they would not be in business in six months. It is a legitimate cost of doing business I would think.

I do not think they are going to have any trouble separating the cost of doing business versus the social engineering kinds of things that you are talking about.

Senator SHAHEEN. I had asked before you got here if there were recommendations to try to incentivize innovation and help the businesses grow. So, I think you were talking about that in response to that.

Ms. NELLEN. That was a temporary measure.

Senator SHAHEEN. Sure. Right.

Ms. Arslan, then Mr. Canty.

Ms. ARSLAN. You know, I think for America's smallest businesses is really the equity issue. I think that the tax code in particular is one of the biggest contributing factors to this Main Street versus Wall Street, you know, head to head battle royal, because, you know, our members cannot afford to, most of them do their taxes themselves. They do it with fear that they are going to make a mistake.

Two, they cannot afford the teams of lobbyists to come up here and put in all of these different nice loopholes and credits that would benefit them and their business. And so, it creates a strong sense of frustration amongst these business owners who are playing by the rules, who are paying these exorbitant tax rates which inhibits them are growing their business and do not get the same benefits.

In terms of provisions, you know, for our members it is just being treated as an equal business owner. Why is it that a self-employed business owner is treated less than a business owner who owns a C Corporation? Why cannot they have the exact same benefits, the exact same deductions just because of business structure? And so, those are some issues.

So, one of the big provisions is just simply changing the definition of employee for a business and allowing the self-employed business owner to be considered an employee of their business.

It would change everything. It would allow them to deduct their health care costs which every other business gets to do. It allows them to participate in their retirement plans, in their HRA plans. That goes a long way for parity. So, that one simple change in the tax code would make a big difference for the 22 million self-employed Americans.

Senator SHAHEEN. I certainly appreciate that. Back when I was in the State Senate in New Hampshire, I tried to change our state law to help self-employed people qualified for workers compensation; and because of the federal law, we could not do it. It does not make sense when you think about the requirements and the needs that self-employed business people have.

Mr. Canty.

Mr. CANTY. Yes, one of the issues here that I hear and I just heard from my colleague here is a lot of this ends up being cultural.

Number one, what is a small business? A small business, in my NASE code it is actually less than $33 million a year. And then, what is a wealthy person? That is one of the things that has always divided us. I think the latest tax code, I think they bumped it up 250 to 400 K.

Well, if I am a small business and I am doing 20 million a year and I am doing five percent, and that is $1 million, 5 percent, just to be even very conservative gross and the net I am doing 2 and a half percent, well, then that is $500,000 of income to me as an S Corporation owner that again is flowing through me.

Then, I am all of a sudden part of this wealthy class of people when, in fact, I am not. I am the same guy who puts his feet on the ground and goes to work every day and starts solving problems as soon as he wakes up and everything else.

Yet when we go to certain members of Congress, and I say that because you guys are the ones who make the laws and we abide by them, well, then we are being told, well, you do not have anything to complain about. You are rich. What do you have to complain about? I am not rich at all. I drive a Ford Explorer. I live in a decent neighborhood. My kids go to public school and everything else. I am not a wealthy person.

Wealthy to me, just for me to set the record straight for myself is when you can reach into your pocket and whatever you want to buy, the money is in your pocket. You never have to worry. That is being wealthy, and that is a very few percentage of the United States.

But small business owners are being put into that high tax bracket being called a wealthy. WE really need to stop doing that because what it does is that it separates us, and then it takes away the logic out of the argument and then becomes completely emotional. That is something I would love to see from you guys.

Senator RISCH. You know, you do not know the half of it.

[Laughter.]

I get in these arguments up here all the time and this business about, well, they can afford to pay more taxes. But, you know, the tax policy in this country is such that it absolutely amazes me. Sometimes I think they have quit teaching economics in the public school system.

But, if you tax people who are at the upper end of the spectrum, can they afford it? Absolutely they can afford it. In fact, they do not even know it. Their accountant usually writes the check and they have no idea. But, where is that money coming from? Is it going to come out of their richness that a lot of people around here love to hate? Is it going to come out of their lifestyle, their car, their house, or their trips? Of course not.

Do you know where it is going to come out of? It is going to come out of the money that they used to invest that makes America work. It is going to come out of the money that they use to build buildings, to build infrastructure, to hire people to run businesses. That is where that money is going to come from and guess where it is going to go?

It is going to go to the United States government. What could possibly go wrong there? I mean, you are taking it from the most productive group of Americans, handing it over to the Federal Government, and taking it out of the working capital in this country.

This business of, "Oh, well, we will just take it from them; they can afford it," is just nonsense, absolute nonsense.

Senator SHAHEEN. Mr. Zinman.

Mr. ZINMAN. I do not want to lose what Mr. Canty said. I think he is 100 percent correct. There are so many people that I personally, small businesses that my members all talk about who are making the $500,000 and just getting by. These are not rich people but they are being taxed at the alternative minimum tax, and then in my New York metropolitan area you add on a second layer of state and local taxes. These people are between FICA and the federal taxes and then the state and local taxes, they are just getting by. They are not living high on the hog. They are getting by.

And, Mr. Canty, you are absolutely right. A lot of people are in your same boat and perhaps some of these folks over here in D.C. do not understand it but we do.

Senator SHAHEEN. Thank you.

Before I call on Mr. Hodge, I want to go back to Mr. Keeling, and I may have missed this when I was going to vote but one of the things that you talked about when we went around for introductions was the way that ESOPs were able to continue to employ people throughout the recession. I wonder if you could talk a little bit about how that has happened and how they have been able to continue to build the wealth of their employees.

Mr. KEELING. There are no set theorem as to why jobs were so stable in employee-owned companies during the Great Recession. I have my own idea. I have been around ESOP companies since 1981. I have visited over 500 ESOP companies in my career.

One unpublished study showed that ESOP companies are right-sized to begin with.

Senator SHAHEEN. Can you explain what you mean by right-sized?

Mr. KEELING. I will with my left hand parallel to the desk. The study showed that if one took a line represented by my left hand and the hand is the number of employees at a beginning point the companies that were not employee-owned added employees when times were good—up where my right hand is. Then when times were bad their employment level was down here. The same study of employee-owned companies and the number of employees stayed pretty much the same, in good times and in not so good times.

The theorem is, and the book "Shared Capitalism at Work" contains 100,000 points of data. People who feel ownership monitor one another. There is an attachment I have to my testimony that cites recent research about the growth of employee-owned companies during the great recession.

But, I think much of their impressive low layoffs is because ESOP companies were right-sized to begin with and thus maintained a level workforce.

For example, I think of a company in New Hampshire, where times became challenging. Instead of laying off people, employees mowed the yards out in front of the building. They mopped the floors and swept the floors versus saying we are going to lay off people. They kept employees and cut down other expenses because the company believed in saving jobs.

That is the best I can do with it. I just cannot come in and say blah blah blah. I gave you my thoughts, my anecdotal experience on the topic.

Senator SHAHEEN. Thank you.

Senator RISCH. We have to go vote.

Senator SHAHEEN. Yes. Senator Risch and I need to go vote.

Chair LANDRIEU. I am here.

Senator RISCH. The A team is back

Senator SHAHEEN. You are back. Very good.

Chair LANDRIEU. Thank you all so much. Mr. Nelson.

Mr. NELSON. Yes. First of all, I just want to say thank you for inviting me here today. It has been a real pleasure. I do have a plane I have to go catch, get back to Idaho, get back to work.

So, I am going to leave you with a couple of my last thoughts here. I agree with most everybody what they are saying. We need to simplify this a lot and make it an equal playing surface for all companies. I think that would help tremendously in my experience looking over it all.

I want to be clear that, you know, in my business it is very capital intensive. I need to get something like that 179 on a permanent basis. That lets me know where I am coming from, lets me project my futures. I can spend more money than I normally would to regain and get back some of those costs that I am not getting now if I can buy some equipment.

So, I guess the bottom line is there if I get something like the 179 permanent, I can grow my business. I have every intention. I plan on taking over Brown Rental probably in the next 30 days. Within the first two years, we are going to put up about three more locations.

That is more families that I am taking care of, more people, more jobs. And so, that is why it is really important, in my eyes, to get some of these things simplified and yet some permanence going.

Chair LANDRIEU. Thank you very much. Excellent points. If you have to excuse yourself, please do.

We are going to go on until five o'clock. Okay.

I walked in when you were speaking, Michael, and I did not want to miss what you said. I will come back to you in a minute.

But, Mr. Hodge, you wanted to say something.

Mr. HODGE. Yes, Senator, thank you. One of the issues I think affecting small businesses the most in the tax system we have not talked about is the estate tax.

It is kind of interesting to hear Senator Risch talk about Micron Technologies. Sadly, the Chairman of micron technologies died in a plane crash a few years ago; and although he had increased the value of the company tremendously during his reign, it did not cost the company a cent in estate taxes when he died because it is a publicly traded company.

And yet, if a private business owner, such as Mr. Canty, passed away, his family would probably have to sell his business in order to pay the 35 percent federal estate tax and probably much more at that.

And so, I think this is one of the untold issues in the tax system that secretly and stealthily is affecting the long-term prospects of small businesses as they tried to grow into larger businesses.

Chair LANDRIEU. Do you know what portion pay an estate tax, what portion of businesses in the country are subject to it?

Mr. HODGE. Not off the top of my head.

Chair LANDRIEU. Okay. We will try to find out. Please continue. Go ahead.

Mr. HODGE. No. That was my basic point. I think the research is pretty clear on the estate tax that, number one, its effects on the economy are much greater than what it actually collects in revenues for the Federal Government.

The compliance costs alone, from the estimates I have seen, actually probably equal to some degree the amount of revenues that it produces for the economy. As we have estimated in our economic models, if you were to eliminate the estate tax overall, it would boost GDP in the long-term by as much as $128 billion a year. It would probably end up generating more revenues for the government because of increased economic growth. So eliminating the estate tax would probably be one of the best things we could do to help small businesses.

Chair LANDRIEU. Wonderful. Okay. Go ahead.

Mr. HODGE. Thank you. Since we opened up the door on other taxes, I would like to add the issue of sales taxes that affects so many of the brick-and-mortar businesses and so many of the small businesses because they do have a difficulty in competing with some of these Internet companies that are avoiding the sales tax.

Now, it is an interesting thing because if you look at it on the revenue side, if you try to score it, you cannot. But the reality is if the states and local governments wind up collecting more revenue because the sales tax is properly being accessed and the Internet companies are competing honestly with the brick-and-mortar companies and the states wind up generating a certain amount more revenues, theoretically they need less from the Federal Government.

Chair LANDRIEU. I am very glad you raised that, because that is an issue. I do not know if Senator Enzi wants to add anything to this, but that is an issue that is under consideration right now. You know, the Senate passed the Marketplace Fairness Act, and I think both of us supported it.

Mr. ZINMAN. NCPAP also supported it strongly.

Chair LANDRIEU. Good. I supported it for exactly that reason because in the event that we do move to a more, even if we stayed where we are, I think it is fair but if you move more to a consumption tax, you want to make sure that everybody is paying their fair share and if you do not, then local governments end up not collecting that tax and end up to make up the revenues elsewhere, either cutting services below where it should be or raising taxes on income which gets back to what you said, Mr. Canty, that that is the last thing you want to be doing is raising taxes or putting more burdens on income.

You want to take that income and those profits, I think, and reinvest back in your business. Was that not the comment that you made?

So, Ms. Nellen, let us get to you and then Ms. Arslan and then Michael, I would since ESOPs are one of my favorites too, I would like to hear what you had to say to Senator Enzi.

Ms. NELLEN. Well, in the context of this multistate issue being raised, that is something I had on my list to address in that there are some issues that Congress will need to address besides federal tax reform, and I think today a trend you would see in even a small business is they are going to have most likely international and multistate operations.

That might not have been the case 10 years ago but certainly today, I mean, they can start selling online and customers could be anywhere. So in addition to the sales tax issue to resolve, there is also income tax nexus that needs to be clarified and modernized.

And then also, the mobile employees and where they need to file. I am a small company, my employee did travel and visit customers in some state, the small business has to deal with the complexities of the rules on withholding being different among the states.

So, I think there are, besides the federal tax reform, there are some multistate areas where Congress needs to step in.

They have been lingering for some time. They are not easy ones because the government and the businesses do not seem to agree on what they want. But, they would be impediments to small and medium-size businesses.

So, it is the sales tax. It is modernizing Public Law 86–272, and addressing some uniformity for the withholding rates when you have got employees working or traveling through different states.

Chair LANDRIEU. And I do not know if the Finance Committee has reached out. I think it has been right now to Senator Enzi just to us but I am sure they must be reaching out to the National Governors Association, the national mayors, you know, the leadership conference of mayors, and NACO, which are the County commissioners I would imagine for some of the things that Ms. Nellen talk about.

Are you familiar with any of that coordination that may be going on?

Senator ENZI. Yes, of course, a lot of it is the same letter that went to all Senators explaining that it was going to be a blank piece of paper that we would start with and then they would come up with a tax rate and then we would have the opportunity to add back in anything, some people call them tax expenditures, some call them tax loopholes, some people call them tax incentives. It all depends on which side of the table you are on. And, every time one is added back in, it would be added back in with those votes being on it knowing what the cost of that would be.

I do not think that it will actually start as a completely blank piece of paper. I think charitable contributions and home mortgages are pretty sacrosanct.

But, beyond that there will be a debate on almost every other piece of the tax code I think. So, if there are things that you currently enjoy or your association currently enjoys, you should make known to us. And, if there are things that we could get rid of that would also help you, it would be helpful to know that as well.

Chair LANDRIEU. To really have the small business community which, you know, we have a range here in our hearing but, you know, there are thousands of other types of businesses and associations. I mean, you are just a representative group.

But, if there could be any kind of coalescing of major organizations, Senator Enzi, that really focused on small business to try to give a unified voice which may be too difficult or too complex to do but that is part of what this hearing is about, to put in order or in priority some of the things that are really, really, really important to startup entrepreneurs, to sustain that economic growth, to simplify, make it remove barriers to starting businesses and keeping businesses, that I think will help everybody.

Now, whether there are a small short list of those things, I do not know but that is what we are trying to dig for here.

Senator, go ahead.

Senator ENZI. I am just very impressed with the diversity that you have among your panelists, between them and the people that they know, we ought to be able to get a lot of suggestions.

And, even if you do not feel comfortable putting them in under your name, I am sure that either through this Committee or through myself or through the Chair, that we would be happy to submit those things.

One of the questions, of course, that is always asked is how public will the letters be. Everybody is a little bit concerned about that because Senators all have constituents and they come down on all sides of issues. But, it is my understanding that the Chair and the Ranking Member are going to take whatever information they get, keep it anonymous, not even let the NSA have it.

[Laughter.]

And during August kind of work out a bill that, following the August recess, we in the Finance Committee can start working through as kind of a skeleton of what we are going to be working on.

Chair LANDRIEU. Well, that is very good insight because I have been struggling with this as the Chair of this Committee. I mean I have certain views as a Senator from Louisiana, and then I have certain views that I think is my responsibility to try to communicate to the Finance Committee as the Chair of the Small Business Committee.

So, our staff is going to be working on that exact thing and how we put something together from this roundtable. The problem with not putting anything together is the voice is not heard. Do you see what I am saying? So, let us keep going because we are making a lot of progress here. Thank you, really.

Senator ENZI. Another important thing on any suggestions that you have if there is something that you need in the tax code, be sure and explain why it is important; and if you have some stories that can be used to explain that, that that is even more helpful.

Chair LANDRIEU. And of course, the broader the application of it, the better. That is why I am so excited to hear from our CPA group because you all really get such a broad, you know, you are a touchstone for so many different kinds of businesses.

Since I was State Treasurer, I learned to rely a lot on the CPAs who help me out when I got in trouble with the numbers. So, I really have come to appreciate, and you are not political in the sense. You are very apolitical. It is just like the Senator said, it is about numbers. It is about you know what is working, what is not working, and I think you can give a lot of good advice to us on this.

Michael, let us go to you and then I will come back through. We are going to wrap up in about 10 or 15 minutes.

Mr. KEELING. I will be brief. One thing about employee ownership and ESOPs that is overlooked in our discussion is if you read our founding fathers, Hamilton and Jefferson and a few others, they emphasize that broadened ownership of property was absolutely essential to a free society and democracy.

I would submit that ownership of land was the prime measure of wealth in our nation when they wrote. Now ownership of productive property is the prime creator of wealth. Having ownership be broad-based is important.

And, the ESOP community would like to see retained the laws encouraging the creation and operation of ESOPs, which were added primarily in the 1980s under the leadership of, of course, Russell Long; but there was a fellow named Ronald Reagan that had much to do with the inclusion of pro-employee ownership in tax laws.

The employee ownership movement really grew California from a libertarian thought and many of that group became the kitchen cabinet for Governor, then President, Reagan.

There is a book coming out in September by Yale press—I wished I had a copy with me—that will talk about how the first Congress of the United States dealt with an economic crisis in the whaling industry, and one of their solutions was to put some criteria in a law that helped the whaling industry which, by the way, was the oil industry back when the United States began insisting that the sailors on the ships that were harvesting whales share in the ownership of the profits of the whaling ships.

So, I would submit that we will be asking, Senator Enzi, for, in essence, the three remaining special laws in the tax code that promote ESOPs. And, plus Chair Landrieu has cosponsored legislation with Senator Cardin that will add one more tax benefit. My statement, to the Committee and the staff, specifies these laws and the one proposal.

But, I emphasize that the roots of the idea of more ESOPs also includes one that was added by a man named Senator John Breaux, that you may be familiar with.

But having said that, the roots of the concern of Senator Long when he learned about the idea of broadened ownership was the idea of income inequality, or quote, “the rich getting rich and the poor getting poorer.”

And, income inequality in society creates a bad atmosphere of us versus them. Us versus them is not good in our homes. It is not good in our companies. It is not good in our states, and it is not good in a democracy based republican form of government.

And, I think—the Chair said one of the criteria we were to base our statements on was the idea of parity. The greatest system known to mankind in terms of an economy is a free enterprise economy.

You need to make it be all it can be. Otherwise, you get into us versus them leading to entitlements that have gone out the door in terms of being over broad, or the awful system of the government taking ownership and trying to make things fair.

That is the roots of what we come forward to the Small Business Committee, because most businesses in the world are small business. I do not care what country you are in.

Chair LANDRIEU. Michael, I really appreciate your advocacy and passion, and you know I support a lot of what you all have advocated. I hope you gave them your best line which is if you want to have a capitalist system, you need to have more capitalists.

Mr. KEELING. Right.

Chair LANDRIEU. And one of the best ways to have capitalists is to get people to help to own their own businesses just like land ownership is important. Being an owner of a business or an investor in the business really helped change a persons mind set.

Mr. KEELING. Right.

Chair LANDRIEU. And I think our country should be leading the world in that. I mean, I think our country is so strong because of that. When I travel, I do not see that in many places. I mean, one of the most startling things to me, not the filibuster here because we are not supposed to do that anymore around here, is, you know, one of the most startling things I see is the lack of individual ownership of land.

When I travel to places like Guatemala where 1 percent of the people own everything and 99 percent of the people do not own much, it is not that the 99 percent are not hard-working, smart, and want to work, they own nothing to leverage their finances to either start a business, buy a house, et cetera, et cetera.

One of the great, I think strongest pieces of our government has been private ownership. It is broadly spread in America. I think about that the same that you do if we could allow the barriers to be lower and let people rise on their merit to become capitalists and to be business owners and own parts of businesses, that would have the same breathtaking impact that private ownership of land has had which I would say is breathtaking. I mean, it is breathtaking as relative to other places in the world.

And so, I cannot be more eloquent than you on your subject but it is important to think about. It is simplification, what are the barriers that help people really get capital and build wealth.

So, the government is not redistributing it, the government is helping people to build it. I mean, I think that is a good principle to think about particularly in this Committee.

Chris, go ahead and then we will get you, Ms. Arslan.

Mr. EDWARDS. Yes, I think your comments are spot on; and in fact, to go on a bit of a tangent, this is the crucial problem with

American Indian reservations, of course. The folks do not own the land. They do not have entrepreneurs because they do not own anything. That is a huge problem but, of course, not under this Committee's jurisdiction.

Chairwoman Landrieu, you asked about startups. There was an excellent piece in the Washington Post the other day by Bob Samuelson, who had some very disturbing statistics about how the rate of business startups in the United States has declined. That is a real problem.

Chair LANDRIEU. But declined over what time? Has it been reclining since the recession?

Mr. EDWARDS. The last half of the decade he is talking about.

Chair LANDRIEU. So in the recession period?

Mr. EDWARDS. Yes.

Chair LANDRIEU. But what was it doing before then? It was growing?

Mr. EDWARDS. I do not know the answer to that but, you know, the unemployment rate is staying high because we do not have new startups hiring new people.

Chair LANDRIEU. Right.

Mr. EDWARDS. One small item that I think this Committee could address and the Finance Committee could address in tax reform is the issue of startup expenses.

I am not an expert on this but it has always struck me that, you know, I think current laws you can expense about $5,000 of startup expenses. But above and beyond that you have to amortize the startup expenses over 15 years. That strikes me as crazy. We want Americans to start firms.

Chair LANDRIEU. Maybe startups should be free.

Mr. EDWARDS. Absolutely.

Chair LANDRIEU. Maybe startups should be completely free. You do not pay any tax for the first year until you get yourself going, and then you will be much better and able to pay taxes later on.

I have had any number of my constituents come up and ask me that. Why, if I am starting this business, why would I have to pay all these taxes initially? Why do we not just let us start up the business? We will be more profitable, and then we are happy to pay a fair share.

Mr. EDWARDS. Right.

Chair LANDRIEU. I think that is kind of an interesting principle. I do not know how far, I am wanting to throw a lot of new ideas on the table.

Ms. Ashton.

Ms. ARSLAN. One of the things our members have been saying is, you know, the tax code does not need to incentivize them to be a business owner.

Chair LANDRIEU. Right. They are going to be one whether——

Ms. ARSLAN. Exactly.

Chair LANDRIEU. They are entrepreneurial.

Ms. ARSLAN. They are entrepreneurs by nature. They will find a way in any economic climate, environment to be a business owner, to start their business, to try and be successful and make a go of it.

But, what it must do is not disincentivize them, not create barriers and roadblocks for them to be successful by being so complicated, by being so costly, and so that is one of the big messages that they wanted to put forth is that, you know, the way the tax code is set up right now it is a huge disincentive for them to grow, you know, more employees, more problems, more money, more problems.

It is also a big disincentive for people who are thinking about starting a business because of that regulatory burden. You know, and when we talk to them, you know, Mr. Enzi had said, when we talk to them about if we could throw everything out, what would be the things you would definitively want to keep?

It was four things. It was deduction for charitable contributions, a deduction for their health insurance costs, the mortgage interest deduction, and the home office deduction. Those are the only four things that if they could have a lower individual tax rate, they would scrap everything. Those were the only four things they cared about.

Chair LANDRIEU. Excellent. Excellent. I want everybody to get that on the record. If you have your two things or three things you want to get on the record, get them.

Ms. Sullivan.

Ms. SULLIVAN. I just wanted to put some numbers to your idea about startups which SBA says the average cost to start a business is $30,000 and the average microloan when they are starting a business is $13,000. So, if you are thinking about a deduction for startups, I hope that puts it in context as maybe what we are talking about.

Earlier, I said, you know, our members would just like to start from ground zero, "give us a lower tax rate." You can take all the other credits and deductions.

Especially those lower income entrepreneurs who cannot afford a CPA. They do not even take advantage of them anyhow, those 20 or so deductions that are right now all on the books. You have to know to be able to take advantage of it.

If we are going to add back into the tax code some deductions and credits, we are thinking about principles. The first one was, and I think it was Mr. Edwards who said, an incentive for new businesses to remove financial barriers for business creation. We just want to make sure that we could have a one-time tax deduction.

The other principle is that if you want to add things back in, you should think about encouraging investment in small businesses like angel——

Chair LANDRIEU. Angel investors, et cetera.

Ms. SULLIVAN. Right. And then third, we really like the idea of rewarding employer ownership, employee ownership because we see it as a way to keep your business going and to keep it beyond the owner, the original owner.

So, those are kind of our three principles going forward that if you wanted to add anything back in, that those principles be thought about in terms of the tax code.

Chair LANDRIEU. Mr. Eckert.

Mr. ECKERT. I am——

Chair LANDRIEU. Would you speak into your mic.

Mr. ECKERT. That is a constant problem I have today.

Related to the number of startups and relative to the past and going forward, interestingly we are seeing a new class of entrepreneur emerging in America coming out of the recession, and that is, people who were laid off or who lost their jobs and who could not find other jobs but who had an entrepreneurial instinct or had the need because they simply required livelihood, and we are seeing many of them come to us now with business ideas and we are funding them.

That complements the classic entrepreneur that we see and read about. Just a point, they are driving more startup companies.

Chair LANDRIEU. And you know, necessity is the mother of invention.

Mr. ECKERT. That is right.

Chair LANDRIEU. People have been unemployed so long. There are no jobs like the one they had, and so people are just like, okay, I have got a family to raise, I have got notes to pay, I have got to create my own job. And, they are getting about doing it because that is what Americans do. We do that very well.

Interestingly enough, this health care debate which has not gotten much coverage at all, if you think about, not to get into a debate on the Affordable Care Act here.

But, one of the interesting benefits to it, why I voted for it, and why many people did, not all, if we could ever get it to work, is because you can disassociate your insurance from your employment; and in some ways, it can incentivize entrepreneurship because the idea is your insurance travels with you.

In the old days, it was connected to your employment. Under the Affordable Care Act, although for large companies you can still get your insurance if you do from your employment, the idea is to connect it to yourself.

So, wherever you go, you have your insurance that is affordable. That is a principle of the Affordable Care Act that I do not think gets talked about, but it really is a pro-entrepreneurship idea.

Now, how we can get it to work, because there are lots of problems with the subsidies and the exchanges and everything but that was a very powerful idea of the underlying bill that I do not think has been talked about enough.

We are going to just have one more, anybody else, we are going to wrap up in just a second so put your placard up if you have one more thing to say.

Let us do wrap-up comments. We will get everybody to do a one-minute wrap-up comment.

Go ahead.

Ms. NELLEN. One really big topic that I do not think we spent enough time on, I do not want to overlook it, is simplification. That is really kind of around the edges of many things we talked about.

But, I think really a big emphasis on that would be very important. Basically, I think if you cannot describe in a few simple sentences how a rule works or it requires alternative calculations, the rule is not simple and it needs to be revised or repealed.

Some areas they just kind of bring out complexity. One, for example, that small businesses face is worker classification. You want to hire somebody, not sure if they are a contractor or an employee, you could struggle over that and then the risk of getting it wrong can be high.

Why not just have, you know, like a five-question check list. If you honestly answered all of these questions yes and you then treat them as a contractor, you are fine. If it is determined it is wrong going forward, you can fix it.

I think you need to think of new ways to address some of these things that otherwise have been decades-long complexity that do not tend to get resolved.

Also, another area of complexity businesses face is when there is regulations on something that are very complicated. Right now, small businesses are facing a set of regs regarding repair versus capitalization.

They are 64 pages long. They are incredibly complicated. I would like to see maybe if there is some way that if that happens, if we have a very complicated set of regs, there has to be a backstop, some safe harbor, as another way that a small business of a certain size could come in and deal with that.

I think you need to find ways for the states to be joining with you because you put certain simplifications in place and the states do not follow them, then the complexity remains at the state filing level.

Chair LANDRIEU. 30 more seconds.

Ms. NELLEN. Okay. The blank slate. Small business would want to have use of the cash method, Section 179 expensing, retirement plan provisions, and the self-employed medical insurance deduction but also for self-employment tax; but all of these need to be modified in some way for further simplification.

Thank you.

Chair LANDRIEU. Thank you. Very good. Thank you so much.

Last words, we are just going to go around.

Kristie, starting with you.

Ms. ARSLAN. I just want to leave you with facts because often people get confused about the self-employed, but there are 22 million self-employed Americans; and when you look at them as a percentage of the small business population, 78 percent of all small businesses are self-employed.

So, they are a very important demographic and thus the tax code and any tax reform really needs to be representative or be of help to this particular demographic. As we all know, all businesses start small. So, let us be sure to focus on tax bills or tax reform that really does help all businesses, especially the smallest.

Chair LANDRIEU. Thank you.

Mr. Canty.

Mr. CANTY. You know, this is very real to me in terms of paying the taxes. I remember when I had that AMT bill in 2009 that I still do not understand what it is. I have two children who are, my daughter is severely disabled with autism and my son has a high-functioning form of autism; and as anybody who is familiar with that, there are a lot of different intricate medical bills that are associated with that.

Well, I had to take that money I had set aside for the taxes and pay some of our bills. So, I got a tax lien. I am still paying for that tax lien. Our friends at the IRS really did not care about that. I mean, that is what I said before about the IRS. They do not care if you cannot pay or what your excuse is.

So, there is a real detrimental effects of this to small business, to myself notably; and I will be submitting that story for the record. But, that needs to be considered, cases like that, for small business owners.

Chair LANDRIEU. Absolutely. Thank you.

Mr. Eckert.

Mr. ECKERT. We worry that if the 100 percent capital gains exclusion is not extended and made permanent that significant dollars will fall out on the system and that large numbers of startups will not be funded, companies will not be created, jobs will not be created.

We also feel that by shortening the holding period from five years to two will help the system and keep capital in the system and we think by including LLCs in the law in 1202 that it will help everybody.

Chair LANDRIEU. Thank you.

Mr. Edwards.

Mr. EDWARDS. I would just encourage Congress to focus on tax reform for small businesses and overall, look at ideas that would make the code both simpler and more efficient.

So, you know, the capital expensing is one of those ideas. Section 179, expand it. It makes life much simpler for small business and it is more efficient. I mention, for example, startup expenses. Why are we amortizing those. That just complicates the code. Let us expense them.

With capital gains, I agree with Mr. Eckert's view about 1202. We probably should expand it. It would be simpler rather than doing that just to lower the overall capital gains tax rate. So, think things that are simpler and more efficient.

Chair LANDRIEU. Mr. Hodge.

Mr. HODGE. Well, there is a simple adage in economics that when you tax something, you get less of it, and high taxes on pass-through entities gives us less entrepreneurship, less investment, less risk taking, and ultimately less job growth and job creation.

And so, while we all want to wipe the slate clean, we want a blank slate, there are certain provisions in the tax code that help us define the tax base and help us define taxable income, things like expensing, accelerated depreciation, and so forth.

So, we need to be very, very careful as we reform the tax system, that we do not undermine and take away the things that improve economic growth and reduce the cost of capital and ultimately lead us to a more prosperous economy.

Chair LANDRIEU. Michael.

Mr. KEELING. I put it in my prepared statement that you have, I will personalize them a bit. Number one, we want to save the Breaux approach to S Corporations with ESOPs, and then save these Long-Reagan proposals having to do with exiting shareholders being able to keep their companies going by transferring it to the employees and not having to pay that capital gains tax under certain circumstances.

Then addressing the two income, issues that attracted Senator Long having the dividends be deductible. It is paid in cash to the employees.

And then of course, we would like to add a provision in the tax arena, in the Cardin bill that you are a cosponsor of along with several of the colleagues on this Committee.

Then there are other ideas that we can throw out but I just hit the top four that we listed out to our written statement.

Chair LANDRIEU. Thank you very much, Michael. You did your wrap up. Mr. Nelson had to leave early. So we are down to our last three. Go ahead.

Mr. RANDOLPH. Thank you. I am happy to be part of this discussion. A lot of the tax reform discussion for business focuses on large businesses and multinationals and a lot of the discussion is about broadening the base and lowering the corporate rate, and we have to make sure that small businesses do not get caught in the crossfire of that discussion.

Chair LANDRIEU. Thank you.

Mr. RANDOLPH. Some of those broadening measures, as Mr. Hodge points out, such as for depreciation, would affect small business as well. So, we need to really focus on that.

But going beyond that the discussion really needs to, and that is where this discussion fits in, really needs to focus also on the problems that small businesses face. I am really happy to hear that there are constant calls for permanence, because that is really important.

Specific things we need to focus on are a permanent extension and expansion of 179. Cash accounting the same thing. I echo that again and also the incentive for startups in Section 1202, the 100 percent exclusions and so on. We need to focus on that.

And, we need to focus on things that generally make life simpler for small businesses—you know, cash accounting is one of those types of things—and not try to pepper the tax code with a lot of very complicated incentives at the same time.

Chair LANDRIEU. Thank you so much. I hope you take those ideas back to Treasury and let them know you heard from the Small Business Committee.

Ann.

Ms. SULLIVAN. A lot of people touched on this. Our tax code is really outdated. It is really thinking about business in a very traditional way. As Kristie pointed out, there are 23 million self-employed. You said people are creating their own jobs, a do-it-yourself economy basically. We have access to world markets. Our consultants are all over the place. 1099s are now a way that we do business by being able to employee those folks rather than trying to skirt employer obligations.

There is just a whole different way of looking at business and how business is conducted, and so we are really hoping that when Congress thinks about redoing the tax code it thinks about how business is done today versus how it was 50 years ago and how this complexity has built upon itself.

Chair LANDRIEU. Ann, I think that is so excellent. I am going to make that I think the heading of my letter to the Finance Committee. We are operating in a do-it-yourself economy. Let us have a tax code that helps us do it.

Ms. SULLIVAN. Yes.

Chair LANDRIEU. I mean think about that, I mean, because it is absolutely, it is just breathtakingly different than it was 20 or 30 years ago. I mean, this Internet and the way people conduct business today is so different. We have a tax code that was built for the last century. This is a very exciting opportunity. Whether we can get it done or not, I do not know.

Go ahead, Sandy.

Mr. ZINMAN. Well, to add on to what can just said, too much of the current tax code is burdensome and confusing. The compliance issues are difficult. We need to have an understandable tax code with some amount of permanence.

Granted we live in a dynamic economy but we have always lived in America in a dynamic economy. So, we need to have some amount of permanence so business owners can feel that they know where they are going. Also, one last thing is we do need to coordinate with state and local governments because we seem to step on each other.

Chair LANDRIEU. Excellent point.

Senator Enzi might have a few closing remarks and again thank you so much for being here. I mean we are so happy to have a member of the Finance Committee, because whatever letters we decide to send or not send, we have had a good solid member here listening to this and I think it will really help. I hope it was helpful to you, Senator.

Senator ENZI. It was. And of course, this was my first Committee and it took me a long time to get on the Finance Committee as well. So, I am pleased on there. I guess they did not want an accountant on there. So, that explains a lot on balancing budgets and fixing taxes.

Chair LANDRIEU. It explains why we are in the trouble we are in.

Senator ENZI. And, I just appreciate all of the comments. There have been a lot of really valuable suggestions here that I have done, that I have written down.

For the small businesses, I like that do-it-yourself economy. That is the small businesses. Of course, unfortunately our definition of a small business is five hundred or less employees, and this Committee, I have always said that my definition of a small business is where the owner of the place sweeps the sidewalk, cleans the toilets, does the bookkeeping, and waits on customers, and definitely not in that order.

That is who we have got to keep in mind when we are doing this. When I talked to big businesses, I say find a small business that has got the same problem that you have got and help them to be able to explain it and it will fix it for both of you. One of the problems with small businesses is not having the time to find out their problem exactly and then to explain that.

I appreciate the comments on ESOPs. Be sure and watch out for the new fiduciary rules on valuing the ESOPs. For everybody I suggest that when I first was coming back here, there was a company in Missouri that made, redid farm implements. They did a little audiotape called "The Great Game of Business" about how these people that had never owned a business, never really understood their own finances took over an implement business and were able to set it up very competitively and keep it going which was one of the ESOPs.

When we are talking about forms, if you have some suggestions or questions about why anything is on a form. Some of the forms that we have are not very explanatory. In fact, the form 5500 that people have to fill out for health care and insurance, the questions do not match up with the form. When I asked about it, they said, well, if we change the form, then we get penalized under the Paperwork Reduction Act so we just go with the old form and we add to the manual, and that is a problem we have got with a lot of forms.

I was able to change the student aid form from 12 pages down to two just by asking a bunch of questions about, you know, who uses that information.

So, if you can supply that on any of the business forms you have to do, and I am sorry that Mr. Nelson is gone with his small business application that he is trying to do.

There is a Small Business Advisory Committee that works under the SEC. Any time there are regulations that deal with small businesses that amount to $1 million in cost, almost everything amounts to $1 million in cost, this advisory Committee reviews it and helps to decide whether it is a worthwhile rule or not. So, take advantage of that.

In all the states, there is a tax advocate as well. So, if you are having problems that Mr. Canty mentioned, the problems where you had some kids that had some extra bills and stuff, sometimes the state tax advocate can help on that at least illuminating penalties. And I like the suggestion for cash accounting on the small business too. I have a whole pile but I will not go through them all.

Chair LANDRIEU. Thank you.

Senator ENZI. Thank you for having this hearing.

Chair LANDRIEU. Senator Risch.

Senator RISCH. Well, thank you very much all of you for coming. I think this has been informative and I think everybody has come away with some different ideas.

I hope you have taken away from this that there are people up here that actually care about what you do. I know before I got here, I always thought what are these people thinking up there.

Well, now that I am here I can see why a little bit, but there are people here who are actually very considerate of what goes on outside these walls and we appreciate what you do. Keep doing the best you can and we will keep doing the best we can.

Thank you so much.

Chair LANDRIEU. Thank you. I am going to end with one of the most interesting articles that I have read in the Washington Post in a long time. I do not know if you all got to see it.

The headline, and my Ranking Member will love this, watch him pull a USDA-mandated rabbit disaster plan out of his hat. Did you all see that? Now, it should be the subject of the regulatory oversight that we are going to do but it has reference here.

This summer, Marty the magician got a letter from the U.S. government. It began with the six ominous words. Dear Members of our Regulated Community. Washington had questions about his rabbit again. He has been regulated under a regulation that had to do with zoos and circuses; but since Marty has one rabbit, they decided to ask him about his rabbit.

So, we did not get to the rabbit today but we will but we got to a lot of other good things.

So, thank you all very much for coming.

[Whereupon, at 5:04 p.m., the roundtable was adjourned.]

APPENDIX MATERIAL SUBMITTED

Statement for the Record
Submitted by Senator Cantwell
Small Business Tax Reform: Make the Tax Code Work for Entrepreneurs & Startups
Small Business Committee – Russell 428
July 17, 2013

STATEMENT FOR THE RECORD:

Chair Landrieu and Ranking Member Risch, I commend your efforts to bring key constituencies together for an important discussion on reforming the United States tax code and its particular impact on small businesses. In order for American businesses and workers to succeed in an increasingly competitive global economy, we need a simpler, smarter tax code for the 21st century. In Washington state, more than 500,000 small businesses employ 1.3 million workers. Small businesses are a key engine in Washington state's economy. That is why I am proud to have worked with this committee to pass small business-oriented legislation such as the Small Business Jobs Act, which expanded access to capital for small businesses.

The world has evolved significantly since the Tax Reform Act of 1986. In the Information Age, we need a tax code that rewards efficiency and innovation. Our tax code should better reflect an innovation economy – and invest in educating and skilling the workforce needed for 21st century jobs. The tax code should reinforce the strength of America's economy, incentivizing investments that support job creation on Main Streets across our country.

Tax reform provides us with an opportunity to rejuvenate our economy by correcting inefficiencies in the current tax code, as well as an opportunity to make investments in our nation's workforce and the companies that create American jobs. This includes making the tax code easier for small businesses in order to spur job growth. According to the Small Business Association, tax compliance costs for small businesses with fewer than 20 employees are more than $1,500 per employee each year, while compliance costs for large companies, with more than 500 employees are only one third as much. We need to correct such inefficiencies.

In order to continue to be a global leader, the United States must invest in a workforce prepared to drive innovation. This means providing appropriate incentives to educate and train American workers for skilled 21st century jobs. A skilled workforce is a critical component of a productive economy. In a 2011 survey of industrial companies by the National Association of Manufacturers, 67% of respondents reported a moderate to severe shortage of available, qualified workers and 56% anticipated the shortage to grow worse in the next three to five years. To help small businesses, I believe we should provide tax credits to promote apprentice programs and better train the American workforce. Apprentice programs that emphasize "learning-while-doing" are a proven way to incorporate specialized problem-solving skills, as well as workplace knowledge and understanding.

Equally important to small businesses will be prioritizing innovation. I have been a strong supporter of the Small Business Innovation Research program, which enables small businesses to use research and innovation to help create jobs and grow the economy. I believe we should continue to focus on programs and tax incentives that encourage research and development of new ideas and investing in the development of cutting-edge technologies, such as those in the clean energy sector. We need to think globally and grow locally. That means means focus on building a strong workforce here in America by encouraging investments and innovation domestically.

Small businesses employ 54.6 percent of all private sector employees in my state. Given the important role that small businesses play in our economy, they should play an important part in tax reform. Overall, I believe tax reform can move our economy to a more innovative-based approach that is efficient and continues to allow the United States to be a world leader.

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Opening Statement
Submitted to the Senate Small Business Committee
United States Senate
Washington, D.C.

Roundtable on:
Small Business Tax Reform: Making the Tax Code Work for Entrepreneurs and Startups

Submitted by Kristie Arslan
CEO & President, National Association for the Self-Employed
July 17, 2013

The NASE represents the self-employed and micro-business owners (10 employees or fewer), providing business skills education and cost-saving benefits for those looking to start and grow their businesses. Founded in 1981, the association has been the sole voice advocating for America's smallest businesses in all areas of public policy, especially in the area of the tax inequities faced by the self-employed, for the past 30 years.

At present, there are roughly 27 million small businesses nationwide, ranging from 1 to 499 employees and of those, **22 million are identified as self-employed, accounting for more than 79 percent of the entire small-business community, generating roughly $950 million dollars annually in sales** (*2010 Non-Employer Statistics, U.S. Census Bureau*). The majority of our members, roughly 56 percent, have their business organized as a sole-proprietorship, and thus any significant tax reform in the corporate area will have little if any impact on the self-employed.

On behalf of our members, the NASE is in favor of comprehensive tax reform in order to create a simplified tax code that treats all businesses fairly while also removing unnecessary hurdles and streamlining a cumbersome and overwhelming tax filing process. In a 2012 member survey, 78 percent of our members indicated support for tax reform. The same survey showed that our members believe Congress's inability to pass long term tax policy hinders their ability to plan for their business (28%) and creates uncertainty which negatively impacts their sales. More importantly, our self-employed members felt that the lack of movement on comprehensive tax reform further highlighted our government's ineffectiveness.

We have been proactive in communicating to the key lawmakers the importance of ensuring comprehensive tax reform, is indeed ***comprehensive.*** To that end, we have put forth several tax proposals that would be a great starting point for creating an equitable tax code for America's self-employed:

- Amend the definition of "employee" to include the owner and spouse of a sole proprietorship, or a 2 percent or greater shareholder in an S Corporation – a simple legislative or administrative fix to current language which would address many issues related to "fringe benefits" such as retirement plan contributions, health insurance deductions, etc.

- Deduction of health insurance costs for the self-employed as a qualified business expense by adding a line item on the Schedule C form and not on page one of Form 1040 to allow the self-employed a business deduction for health care costs.

- Simplify depreciation calculators, reporting requirements, and accelerated options for most standard business items and amounts, all of which could be included as a line on Schedule C.

- Identify other areas to provide standard deduction options (similar to the home office deduction) based on industry and location.

- Simplify and streamline definition of independent contractor versus employee by expanding the Form 1099 to require the owner and contractor to acknowledge their business relationship.

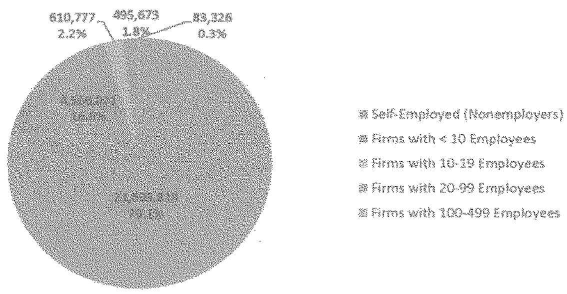
These are the types of bold proposals that if included in the final legislation will be truly transformational in moving from a complex, unfair tax code, to one that encourages entrepreneurship and small business growth.

It goes without saying that any significant reform to the tax code will be challenging, but we believe that putting forth a dynamic, common-sense proposal for bringing the tax code into the 21st Century can be accomplished if the proposal provides for a transformational change to all aspects of the tax code, individual and corporate.

As it stands now, our concern remains that the draft proposal looks only to modify or tweak the current tax code, but falls short of taking a path to overhauling the dysfunctional and complex tax code to both improve compliance and encourage business creation and growth.

The Majority of U.S. Small Businesses are Self-Employed

FACT: 79.66 percent of small businesses in the United States are self-employed.



Source: U.S. Census Statistics of U.S. Businesses and Nonemployer Statistics, 2009

Prepared by the National Association for the Self-Employed (NASE)
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KRISTIE L. ARSLAN
President & CEO
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Kristie Arslan is the President & CEO of the National Association for the Self-Employed (NASE). The NASE is a membership organization that represents the interests of America's smallest businesses – the self-employed and micro-business (fewer than ten employees.)

With years of advocating on behalf of America's self-employed and her own personal experience working for her family's small business, Arslan provides critical insight into the issues affecting our nation's smallest entrepreneurs. Arslan has been quoted and published in the *New York Times, Washington Post, Wall Street Journal, Politico, Roll Call, The Hill* and *CQ Weekly* while having appeared on MSNBC, FOX, CNBC and C-SPAN. She is also an active blogger on Huffington Post.

Kenneth B. Canty, P.E. is President and CEO of Freeland Construction Company, Inc, a Charleston based General Contractor specializing in mechanical, electrical, and civil renovation, restoration and rehabilitation work. Canty has worked for 15 years on a multitude of mega construction projects both in the North and South East United States. He is originally from Boston, MA. These projects include the Central Artery / Third Harbor Tunnel Project in Boston, Long Island Expressway Expansion in New York City, and the Cooper River Bridge Replacement Project in Charleston, SC. Kenneth is originally from Boston, MA. where he attended Thayer Academy and then UMASS/Amherst to study Civil Engineering.

Freeland has offices in not only Charleston, SC, but Savannah, GA and Bowie, MD and employs 25 people. Freeland is a participant in the 8(a) Business Development Program and will graduate in 2018. Currently Freeland has a SBA Mentor / Protégé Agreement with Dragados, USA; one of the largest Construction Companies in the World.

UNITED STATES SENATE
COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

SMALL BUSINESS TAX ROUNDTABLE: SMALL BUSINESS TAX REFORM – MAKING THE TAX CODE WORK FOR ENTREPRENEURS AND STARTUPS

INTRODUCTORY STATEMENT
MICHAEL J. ECKERT
VICE CHAIRMAN, ANGEL CAPITAL ASSOCIATION
JULY 17, 2013

Chairman Landrieu, Ranking Member Risch and members of the committee, thank you for inviting the Angel Capital Association today.

My name is Mike Eckert. I am Vice Chair of the Angel Capital Association, the world's largest professional organization of accredited angel investors. ACA includes more than 200 angel groups and their 10,000 individual members. I participate with angel groups in New Orleans and Atlanta.

ACA has championed the existing 100% exclusion of capital gains in qualifying small businesses– currently scheduled to sunset at year-end. The loss of this exemption would deal a heavy blow to the innovation economy. Incentives are essential to encourage private citizens to continue investing their capital, at high risk.

Angels Fund Majority of Early Stage Deals and are in Every State

Angel investors are the *only* source of capital for most startups, and supply as much as 90% of outside equity they raise. In 2012, angels invested $23 billion in 67,000 early-stage companies. Federal Census data show that startups create *all* net new jobs. **Without angel funding, these businesses would never get off the ground.**

Angels Take Risk – and Plow Returns Back In

Angel investing also provides a "multiplier effect" to the economy. When our companies succeed, we plow our own returns back into the field. This creates even more jobs and results in a stronger, more stable tax base – a virtuous cycle.

Tax Recommendations to Ensure Continued Angel Investment

ACA believes it is essential to maintain federal tax incentives to support this high-risk investment class. The job growth and innovation that result *far* outweigh the small sliver of tax revenue that might otherwise occur.

Today, we are at a critical juncture. With new SEC rules passed last week allowing general solicitation by startups, accredited investors will already have to go through many more hoops to establish their qualifications, likely reducing investment.

ACA believes that removing existing tax incentives could result in thousands of angels backing away. Startups would have less capital, and could lose much of the invaluable advisory support angels provide.

ACA's top priority is to see this exemption made permanent. Certainty is critical. We also believe the five-year holding period is too long, and advocate lowering it to two years. Also, the exemption only applies to "C" corporations, and we recommend extending it to limited liability companies (LLCs) – a common seed-stage structure.

We also believe much can be learned from state tax credit policies that have led to large increases in startup investment.

I look forward to this roundtable and discussion. Thank you.

SUPPLEMENTAL INFORMATION FROM THE ANGEL CAPITAL ASSOCIATION

National Angel Investing Landscape

Angel investors are high-net-worth individuals as defined by the Securities and Exchange Commission, who provide money for start-up firms with growth potential. Many angels started, built and sold their own companies and are now in a position to invest their money and equally important, their time, in new or early stage businesses.

The nation's leading expert on entrepreneurship, the Ewing Marion Kauffman Foundation, estimates that angel investors may be responsible for up to 90% of the outside equity raised by start-ups after the capital resources of their founders, friends, and family are exhausted. These firms rarely have the collateral to receive bank loans and they are generally too small and too young to receive venture capital.

The University of New Hampshire's Center for Venture Research estimates that angels invested $22.9 billion in about 67,000 companies in 2012. One of the trends in the field over the last decade is the growth of angel groups, in which investors join together to invest in and mentor companies, pooling their capital to make larger investments and developing best practices for investing and mentoring. ACA estimates there are more than 375 angel groups, located in every state, more than a three-fold increase from about 100 groups ten years ago.

The HALO Report, the leading assessment of angel investing nationwide, describes the investments angel groups made in 2012:

- Median round size of $600,000
- 70% of investments were in healthcare/life sciences and Internet/IT sectors
- Two-thirds of the investment rounds were syndicated, often with multiple angel groups
- Investments were distributed broadly across the country – two-thirds of the deals were outside of traditional startup equity centers of California and Boston.

Angel investors are proud to be an important resource for the startup companies that have created the large majority of net new jobs in the United States over a 25 year period. Angel-backed companies have been some of the most prolific job creators and innovators in recent times: Google, Facebook, and Starbucks are just a few examples.

Thousands more companies supported by angel groups and individual angels are less known, but significant in the innovative products and jobs they have created.

For example, the South Coast Angel Fund in New Orleans, which has 46 members from throughout Louisiana, has invested in technology, life sciences, and other sectors in companies including:

- Omnicademy, a social networking platform that enables universities and colleges to syndicate their courses
- Bascom-Hunter, which produces hardware and software for the armed services and homeland security

- Camgian Microsystems, which specializes in IT solutions, from power processors to advanced sensing platforms

Angel investors provide seed-stage equity at a rate that is 20 times the number of companies financed by venture capital. In 2012, angels invested $23 billion dollars in 67,000 early-stage companies, while venture capital in total put a few billion into less than 1,800 startups, plus another $20 billion in about 2,000 later stage companies. According to Census Bureau Business Dynamics' data, startups comprise less than one percent of all companies, but generate 10% of all new jobs in any given year. Without angel funding, these fledgling businesses would simply never get off the ground.

Risk and Angel Investment

Returns to Angel Investors in Groups, the first ever dataset and analysis of angel group returns, confirmed what many investors thought about their success:

- 52% of all exit returns less than the capital the angel had invested in the venture (with 35% of all exits losing all of the money invested)
- 7% of the exits achieved returns of more than ten times the money invested, accounting for 75% of the total investment dollar returns
- 31% of the exits returned the investment between 1 and 5 times the investment.

The study, which looked at 1,137 exits from angel investors connected to angel groups in many areas of the United States, also provided data to support that best practices in angel investment lead to better results for investors and the entrepreneurs they invest in. This includes matching investor expertise with the company, conducting a good level of mentoring and monitoring of company progress, and conducting due diligence in reviewing investment opportunities.

It is conventional wisdom that small business is responsible for the majority of net new job creation in the country in any given year. A growing body of focused research, using the Census Bureau's *Business Dynamics Statistics* database, dramatically illustrates that it is a smaller subset of dynamic, high-growth startups that make up the vast majority of that job growth

- According to a Kauffman Foundation study, these so-called "gazelle" firms (ages three to five years) comprise less than 1% of all companies, yet generate 10% of all new jobs in any given year.
- A similar study from the National Bureau of Economic Research using the same database, found that, after controlling for age of a small business, startups account for almost 20% of gross job creation in any given year.

These are exactly the businesses that angel investors – and mostly only angel investors -- invest in. The true shift in job creation has moved away from publicly-traded companies to the realm of startups that are funded almost entirely by private capital.

State Tax Policies Catalyze Investment in Startups

Many states provide tax credits which vary according to the state, but are aimed at increasing investment appetite in startups. Senator Mark Pryor (D-AR) introduced S. 256, the American Opportunity Act of 2011 in the last Congress. This bill would provide a 25% tax credit for qualified angel investment.

Well-designed tax credits in many states have already led to increased angel investment and impact:

- Wisconsin – tax credits have increased angel network investment by more than 30 times, from $1.7 million in 2004 to $59 million in 2011
- Ohio – tax credits of $28.5 million have generated $109.8 million in private investment, a 4:1 leverage
- Kansas – in 2010, $5.7 million in tax credits created or saved 238 jobs and an annual payroll of $36.6 million

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Small Business Tax Reform

Statement of Chris Edwards, Cato Institute,

to the Senate Committee on Small Business and Entrepreneurship

July 17, 2013

Chairman Landrieu and members of the committee, thank you for inviting me to testify today. My comments will examine the importance of capital gains taxation for entrepreneurs and growth companies.

Federal tax policies are a powerful factor in encouraging or impeding business investment, job creation, and international competitiveness. For small businesses and growth companies, capital gains taxation plays a particularly important role.

Reduced capital gains taxes can generate greater financing of young companies by angel investors and venture capitalists. Lower capital gains taxes can also encourage people to become entrepreneurs because the payoff from a successful start-up is improved compared to a wage job. Entrepreneurs put their own money into their ventures and want to maximize the financial returns from their hard work and sacrifice.

Investors in entrepreneurial ventures take big risks in the hope that their bets on unproven technologies and unproven markets pay off years down the road. Their reward for putting up "patient capital" is a possible capital gain on some of their investments, net of their losses on investments gone sour. The U.S. tax system is biased against such beneficial risk-taking because it taxes the gains but restricts the ability to use capital losses.

The higher the tax rate on capital gains, the fewer potential projects will get the green light from investors, who are looking for a certain level of after-tax return. Put another way, higher taxes increase the "hurdle rate" that prospective projects must earn to be viable.

Angel funding for young companies comes from the "personal pocketbooks" of high-earning individuals, who could alternately put their cash into safer investments, such as tax-free municipal bonds.[1] The capital gains tax rate thus directly affects the willingness of investors to place their funds into risky start-up and growth firms.

In the United States, there are roughly 300,000 or more angel investors, who are often entrepreneurs themselves.[2] Their role in funding waves of promising young companies is crucial because some of those firms will grow into major businesses. For example, Andy Bechtolsheim invested $100,000 in 1998 to help launch Google. He was also a co-founder of Sun Microsystems, which itself had been nurtured by venture capital in the early 1980s. Another well-know angel is Peter Thiel, who founded PayPal. His wealth from that venture has allowed him to fund many young companies, including investing $500,000 in 2004 to help launch Facebook.

When angel investors such as Thiel and Bechtolsheim have successes, they will eventually want to exit their investments and realize a capital gain. Then they will often use their after-tax returns to fund more young companies in an ongoing virtuous cycle. A low capital gains tax rate is crucial to this cycle of growth and innovation.

Nowhere has that virtuous cycle been move evident than California's Silicon Valley, which roared to life after reductions in the top federal capital gains tax rate from 40 percent in 1978 to 20 percent in 1981.[3] Many now-famous technology firms were nurtured on the flood of new risk capital available since the late 1970s, including Apple, Microsoft, Ebay, Cisco, and Amazon.

Today, higher capital gains tax rates risk killing off the new Apples and Amazons that we need to power America's economy in the future. Congress should reconsider the recent legislative changes that raised the top federal tax rate on long-term capital gains from 15 percent to 23.8 percent. Capital gains are different than ordinary income, which is why most nations have top capital gains tax rates that are much lower than their top rates on ordinary income.

When state-level taxes are included, the average top U.S. tax rate on long-term capital gains is now 27.9 percent. That rate is much higher than the average rate of just 16.4 percent in the 34 nations of the Organization for Economic Cooperation and Development (OECD).[4]

Eleven OECD countries do not impose taxes on long-term capital gains, nor do some jurisdictions outside of the OECD, such as Hong Kong, Malaysia, and Thailand. The nontaxation of long-term gains used to be the norm in many countries because they properly viewed gains as not being "income." Britain did not tax capital gains until 1965, Canada until 1972, and Australia until 1985. And only in the last few years have long-term gains been taxed in Austria, Germany, and Portugal.

In sum, long-term capital gains are widely recognized as being much different than ordinary income, and they should be subject to low or zero tax rates. Hopefully, federal policymakers will reconsider capital gains tax policy in coming months and reduce our tax rate to at least the average rate of our trading partners in the OECD. A lower capital gains tax rate would boost innovation, spur entrepreneurship, and help America regain its competitive edge.

Thank you for holding this important hearing.

Chris Edwards

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[1] David Verrill, Angel Capital Association, testimony to the Senate Committee on Finance, September 20, 2012.
[2] Scott Shane, "The Importance of Angel Investing in Financing the Growth of Entrepreneurial Ventures," Small Business Administration, September 2008.
[3] In addition to capital gains tax cuts, rule changes for U.S. pension plans in 1978 helped boost the U.S. venture capital industry by allowing higher-risk investments.
[4] Chris Edwards, "Advantages of Low Capital Gains Tax Rates," Cato Institute Tax and Budget Bulletin no. 66, December 2012.

Chris Edwards
Director, Tax Policy Studies
Cato Institute

Chris Edwards is the director of tax policy studies at the Cato Institute and a top expert on federal and state tax and budget issues. Before joining Cato in 2001, Edwards was senior economist on the congressional Joint Economic Committee examining tax, budget, and entrepreneurship issues. Previously, he was a consultant and manager with PricewaterhouseCoopers and an economist with the Tax Foundation.

Edwards' articles on tax and budget policies have appeared in the *Washington Post*, the *Wall Street Journal*, the *Los Angeles Times*, *Investor's Business Daily*, and other newspapers. He is the author of *Downsizing the Federal Government* and co-author of *Global Tax Revolution*. He holds a B.A. and M.A. in economics.

Scott A. Hodge
President
Tax Foundation

Scott A. Hodge is president of the Tax Foundation in Washington, D.C., and is recognized as one of Washington's innovative thinkers on tax policy, the federal budget and government spending. Over the past 20 years Scott has been a leader in many successful efforts to change public policy. During the 1990s, he led the campaign to include the $500 per-child credit and capital gains tax cuts in the Contract with America. These tax cuts were the eventual centerpieces of the 1997 tax bill and the Bush tax cuts in 2001 and 2003.

He has been the creative force behind the Tax Foundation's Putting a Face on America's Tax Returns project and the State Business Tax Climate Index, two programs that are changing the terms of the tax debate at the federal and state level. Scott has written and edited three books on the federal budget and streamlining the government and has authored over 100 studies on tax policy and government spending. He has also authored dozens of editorials and opinion pieces for publications such as The Wall Street Journal, The Washington Post, USA Today, The New York Post and The Washington Times. Hodge has conducted over 600 radio and television interviews—including NBC Nightly News, CBS Nightly News, CNN, Fox Network, Hardball with Chris Mathews, and C-SPAN. In addition, he has contributed to stories on wasteful spending aired by ABC's "Prime-Time Live" and "20/20," and NBC's "Fleecing of America."

Before joining the Tax Foundation, Scott was Director of Tax and Budget Policy at Citizens for a Sound Economy. He also spent ten years at The Heritage Foundation, including eight years as Heritage's Grover Hermann Fellow in Federal Budgetary Affairs. Scott began his career in Chicago where he helped found the Heartland Institute in 1984. He holds a degree in political science from the University of Illinois at Chicago.

Written Statement of J. Michael Keeling, President of The ESOP Association, to the Senate Committee on Small Business and Entrepreneurship's July 17, 2013, Roundtable on *Small Business Tax Reform: Making the Tax Code Work for Entrepreneurs and Startups.**

Thank you, my comments focus on employee ownership through the ESOP model.

ESOPs are often referred to as ERISA plans. The record should show that an ESOP is a tax qualified deferred compensation plan that by law is required to be primarily invested in employer securities and may use borrowed funds to acquire the assets of the plan.

I comment primarily on the inquiry: "What should a reformed tax code retain to help America's employee-owned businesses?" While my comments are directed to employee-owned businesses, as this Committee knows, the overwhelming majority of economic units in our nation are small businesses, not publicly owned and traded on stock markets. Thus, nearly all ESOP companies, and we have approximately 1500 ESOP company members, and in my career I have personally visited in over 500 ESOP companies are small businesses. The dominant number of employees of our members is in the 100 to 250 employee range. Let me be clear, however, successful ESOP companies often grow pass the formal 500 employee level that defines what is a small business.

Key for the ESOP community is to maintain the three tax law provisions that encourage the creation and operation of employee ownership through the ESOP model.

One, ensures that S corporations that sponsor ESOPs are not disadvantaged compared to conventionally owned S corporations. The 1997 law that permitted S ESOPs made clear that an S with an ESOP is not to pay a corporate level tax just like as other S corporations do not pay a corporate level tax. ESOP participants pay income tax on distributions from their S corp ESOPs. (Specific Code Section 512(c)(3))

Another important tax deferral benefit for ESOPs added to the code in 1984, and it is the key provision encouraging the continuation of private ownership, when the original owner/ founder with no heirs wanting to take over the private company exits the company. This law provides that the exiting shareholder may defer capital gains tax on the sale of shares to an ESOP if the ESOP owns 30% or more of the highest class of shares after the transaction, and the seller reinvests proceeds in the securities of operating U.S. businesses. When the seller sells securities acquired with the proceeds of the sale to the ESOP, he or she pays capital gains taxes on the basis of the shares sold to the ESOP. (Code Section 1042)

The last unique tax law for ESOPs, again added in 1984, permits a C corporation to deduct the value of dividends paid on stock in an ESOP if the dividends are passed through to the employees in cash, or if the employee directs the dividends be reinvested in his or her account for more stock, or if the employer uses the dividends to pay the debt incurred to acquire the shares of the ESOPs, with more shares being released to the ESOP participates. (Code Section 404 (k))

*Attachments is a summary on performance of private ESOP companies evidenced in recent research.

In terms of what is needed to expand the opportunity for more Americans to be owners in the places where they work, topping the list is a provision of S. 742, introduced by your Committee colleague Senator Cardin, and which both this Committee's chair and ranking member have co-sponsored. Section 3 of S. 742 would expand the tax gains deferral provisions of current law to sell S shares to an ESOP.

In terms of others provisions that our community believe should be seriously considered, here are a few we desire: 1. An S corporation like a C corporation should be able to pay "dividends" in cash to employees in the ESOP, and the employees of course would pay tax at that time to Uncle Sam on the dividends, 2. Congress basically repealed in 1989, a law adopted in 1984 that encouraged lenders to make loans to create ESOPs, by permitting the lender to exclude 50% of its interest income from its income, 3. There was for a time a variety of tax laws that encouraged estate planning of owners of private businesses to pass along in their wills ownership to the ESOP, and the ESOP would take on the responsibility for paying the estate tax.

I will stop here, but other ideas have surfaced over the years.

I conclude with two comments.

One, the General Social Survey of 2010 evidenced that during the Great Recession, employee stock owned companies laid off employees at a rate of 2.6%, whereas conventionally owned companies laid off employees at a rate of 12.1%!

Why if the focus of national policy is jobs, jobs, jobs, is there not more national push for the best jobs policy in America today, which has a proven record that it leads to people keeping their jobs that are locally controlled – our modest policy encouraging employee ownership?

Finally, I go to the roots of why Louisiana and Senate icon, the late Senator Long became such an advocate of broad based ownership – income inequality in America. The roots of his dedication to broad based ownership was to enhance the wealth of working men and women in comparison to those whose wealth is primarily through ownership in the most successful economic model ever known to humans, the free enterprise system. Please keep in mind, income inequality creates an us versus them feeling among the people. Us versus them is not good in our homes; in our schools; in our companies; and not good in a democracy based, republican form of government.

Surely our tax laws need to have reasonable policies to encourage less us versus them that can lead to government ownership of property, or massive government redistribution of wealth schemes.

I thank the Committee for this roundtable invitation, and look forward to discussion.

Employee Owner Impact Corporate Performance Positively

Overwhelming Evidence ESOP Companies More Productive, More Profitable, and More Sustainable, Providing Locally Controlled Jobs

- During the Great Recession, employee stock owned companies laid off employees at a rate of less than 3%, whereas conventionally owned companies laid off at a rate greater than 12%. (Data source: 2010 General Social Survey.)

- Because employees of ESOP companies were four times more likely to retain jobs during the Great Recession, Federal government recognized savings of over $14 billion in 2010 compared to tax payments foregone by laid off employees of conventionally owned companies; in other words for every $1 in tax expenditures to promote employee stock ownership, the Federal government collected $13 in taxes. (Data Source: 2010 General Social Survey analyzed by National Center for Employee Ownership.)

- A survey of 1400 ESOP companies in 2010 evidenced the average age of the companies' ESOPs were 15 years, and the average account balances for employees were nearly $200,000, much higher than data reported for average 401(k) account balances. (The ESOP Company Survey, 2010, of The ESOP Association's Corporate members.)

- According to 2012 General Social Survey, 13% of employees of employee stock-owned companies were thinking of seeking employment elsewhere, whereas 24% of the employees of conventionally-owned companies were considering leaving their current job.

- S corporations with employee-ownership grew employment at a rate of 60% during the Great Recession. Analysis by former staff member Bowles-Simpson Tax Commission and staff member of President Bush's Council of Economic Advisors.

- Research done by visiting Professor at Georgetown University's McDonough School of Business, and former Assistant Secretary for Economic Policy U.S. Treasury, Philip Swagel, and Executive in residence at American University School of Public Affairs and former Deputy Assistant for Tax Analysis, U.S. Treasury, Robert Carroll, evidenced S corporations with employee-ownership through ESOPs performed better than conventionally owned firms in providing retirement security.

- More than half of the ESOP companies have two retirement savings plan (primarily a 401(k)), whereas more than half of all companies have <u>no</u> retirement income savings plan. (Analysis of forms 5500, and Bureau of Labor Statistics by the National Center for Employee Ownership, funded by the Employee Ownership Foundation.)

- The average ESOP company (less than 200 employees) has sales $9 million more per year than its non-employee owned comparable competition. (June 2008 Dissertation, Dr. Brent Kramer, CUNY.)

- A study of 1100 ESOP companies over eleven years compared to 1100 comparable conventional owned companies evidenced the 1100 ESOP companies had better sales, more employment, and were more likely over the period to remain independent businesses by 16%. (Most detailed study of ESOP companies by Dr. Joseph Blasi, and Dr. Douglas Kruse, tenured professors, Rutgers University School of Labor and Management, 1999.)

J. MICHAEL KEELING'S BIOGRAPHY

J. Michael Keeling, CAE, is the President and Chief Staff Officer of The ESOP Association, a national trade association promoting the growth of employee ownership in America through Employee Stock Ownership Plans, or ESOPs.

Prior to becoming President, Michael was General Counsel of the Association beginning 1985 and prior to 1985, he represented the Association on several legislative initiatives before Congress. While General Counsel, he maintained a private practice of law focused on legislative and administrative issues related to tax and retirement income policies.

During the 1970's, he was Chief of Staff for the late Congressman J. J. Pickle of Austin, Texas. Prior to that, he worked as an aide in several statewide campaigns in Texas, as a private consultant to labor and farm groups, and as an employee of the Texas State Legislature.

He is a graduate of Yale University and the University of Texas Law School.

The American Society of Association Executives has certified Michael as a Certified Association Executive. He is listed in *Who's Who in American Politics* and *Who's Who in America.*

Small Businesses Tax Reform Roundtable

U.S. Senate Committee on Small Business and Entrepreneurship

Introductory Comments of

Professor Annette Nellen
San José State University
http://www.21stcenturytaxation.com/[1]
annette.nellen@sjsu.edu

July 17, 2013

Thank you for discussing tax reform and small business and the invitation to participate in today's roundtable. I'll offer a few points briefly at the start. I'd be glad to elaborate further today and submit detailed written testimony on these items as well as others raised today.

1. What is a "small" business? Too many parameters and bases are currently used to define this term. Use the easy ones, such as gross receipts rather than full-time equivalent employees and consider that many small businesses have no employees.
2. Consider trends to help modernize our tax system. These include growth in numbers of self-employed entrepreneurs, working out of your home, greater focus on intangible assets, and the reality that today, any size business is likely involved in international and multistate operations.
3. Consider appropriate use of technology to ease compliance. Why can't filing of a return, W-2s and 1099s be as easy for a small business as ordering something from Amazon?
4. Improve equity among rules such as allowing self-employed to deduct health insurance in computing self-employment tax, and enabling similar funding access among entity types, such as through Sections 1202 and 1244. Be sure the research credit includes R&D on cloud computing solutions and helps start-ups with a partially refundable credit.
5. Improve certainty for inherently complex rules, such as worker classification, by allowing use of a safe harbor Q&A checksheet.
6. Include measures to reduce the tax gap to help reach revenue-neutral reform and improve fairness among taxpayers.
7. Encourage and help states to join in tax reform to ensure small businesses don't continue to face complexity at the state level.
8. Simplify! If you cannot describe in a few simple sentences how a rule works or it requires alternative calculations, the rule is not simple and either needs to be revised or repealed.
    a. Recognize that for small businesses, simplification may trump accuracy. For example, a standard deduction for home office expenses, may be warranted to

[1] This URL is to a website maintained by Annette Nellen for the purposes of promoting modernization of tax systems and consideration of the principles of good tax policy, with opportunity for readers to post comments. Views represented at this website are Professor Nellen's views only and may not represent those of her employer or professional organizations of which she is a member.

simplify compliance. Or, tax forms may need to be consolidated, such as is allowed for employers of household employees.

b. Avoid temporary provisions and numerous changes that complicate the tax law and increase compliance costs.

c. Simplify depreciation by expanding Section 179 to a permanent, inflation-adjusted large dollar amount that also covers all intangible assets, such as acquisition of a domain name.

d. Avoid new complexities disguised as small business benefits, such as a deduction for domestic business income of qualified small businesses. Lower tax rates and simplicity are the best tax benefits.

e. Find ways to consolidate duplicative provisions, such as multiple retirement plan options.

f. Require administrative alternatives to compliance with regulations found to exceed a minimum complexity tolerance level for small businesses.

9. For the Senate Finance Committee's "blank slate" approach to tax reform, let them know that key tax expenditures for small businesses include use of the cash method,[2] Section 179 expensing, retirement plan provisions, and the self-employed medical insurance deduction.
10. Once you have draft legislation, get input from small businesses and tax practitioners.
11. Pursue multistate tax reforms that will help small businesses such as ones to simplify and clarify payroll requirements for virtual and mobile employees, as well as income and sales tax nexus rules.
12. Evaluate all proposals for change against the principles of good tax policy.[3]

Thank you. I look forward to the discussion.

[2] Note that the Joint Committee on Taxation treats use of the cash method as a tax expenditure, but OMB treats it as part of the normal income tax structure.

[3] See http://www.cob.sjsu.edu/facstaff/nellen_a/TaxReform/PolicyApproachToAnalyzingTaxSystems.pdf.

ANNETTE NELLEN, CPA, ESQ.

Annette Nellen, CPA, Esq., is a professor in and director of San José State University's graduate tax program (MST), teaching courses in tax research, accounting methods, property transactions, state taxation, employment tax, ethics, tax policy, tax reform, and high technology tax issues. Annette has over 25 years of experience in the area of taxation with emphasis on tax policy and reform for the past 18 years.

Annette is a member of the AICPA Tax Reform Task Force, and the immediate past chair of the AICPA Individual Taxation Technical Resource Panel. She a member of the Executive Committee of the Taxation Section of the California Bar. Annette is a regular contributor to the AICPA *Tax Insider* and *Corporate Taxation Insider* e-newsletters. Annette was the lead author of the AICPA tax policy concept statement #1, *Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals* (2001), still in use today.[1]

Annette is the author of Bloomberg BNA Tax Portfolio #533, *Amortization of Intangibles*. She is also the author of Bloomberg BNA's Legal & Business portfolio, *Overview of Internet Taxation Issues*.

Annette has testified before the House Ways & Means Committee, Senate Finance Committee, California Assembly Revenue & Taxation Committee, and tax reform commissions and committees on various aspects of federal and state tax reform. She maintains the 21st Century Taxation website and blog (www.21stcenturytaxation.com), as well as several websites on tax reform, state tax nexus and e-commerce taxation.

Prior to joining SJSU, Annette was with Ernst & Young and the IRS.

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[1] Available at http://www.aicpa.org/interestareas/tax/resources/taxlegislationpolicy/pages/taxreform3.aspx.

American Rental Association

Statement by Greg Nelson
General Manager, Brown Rental
Boise, Idaho
President of the ARA of Idaho
On Behalf of the American Rental Association
July 17, 2013
Before the United States Senate
Committee on Small Business and Entrepreneurship

Chairwoman Landrieu, Ranking Member Risch and Members of the Senate Committee on Small Business and Entrepreneurship, thank you for inviting me to share my thoughts on *IRS Section 179 Small Business Expensing* at this important round table on Small Business Taxes. My name is Greg Nelson and I am the general manager of Brown Rental, an equipment rental business located in Boise, ID. I am here today representing the American Rental Association (ARA) and the ARA of Idaho of which I am the current president.

Equipment rental businesses require significant capitalization because all rental businesses must purchase new equipment each year just to maintain their inventories. When the economy is strong, these businesses will also buy additional equipment to expand their inventories. IRS Section 179 helps small equipment rental business owners make capital investments if it contains adequate expensing and phase-out limits, is permanent and indexed for inflation.

The purpose for section 179 is to help small businesses invest in capital assets by allowing them to deduct the cost of qualifying equipment purchased during the tax year. Reducing a business' tax liability for purchasing capital assets is positive for the business and the economy because it allows businesses to buy more equipment than they would if they did not have the reduced tax liability provided by section 179. However, we need certainty in section 179. Over the past decade, small business advocates have fought for a series of extensions to the underlying provision which has a $25,000 annual expensing limit that begins phasing out at $200,000. The current provision for expensing $800,000 which phases out at $2,000,000 of investment expires on December 31 of this year.

Along with the American Rental Association, I support making section 179 permanent with levels that are adequate and indexed for inflation to allow small businesses to grow. Such action will remove the uncertainty of the past decade and empower small business owners to proceed confidently with planning and growing their businesses which creates jobs, tax revenues and economic growth.

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simplify compliance. Or, tax forms may need to be consolidated, such as is allowed for employers of household employees.

b. Avoid temporary provisions and numerous changes that complicate the tax law and increase compliance costs.

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WIPP
Women Impacting Public Policy

Senate Committee on Small Business and Entrepreneurship

Small Business Tax Reform: Making the Tax Code Work for Entrepreneurs and Startups

July 17, 2013

Ann Sullivan
on behalf of Women Impacting Public Policy

Thank you Chair Landrieu, Ranking Member Risch and Members of the Committee for the opportunity to be a part of this important roundtable. I am speaking today on behalf of Women Impacting Public Policy (WIPP), a national nonpartisan public policy organization that advocates on behalf women entrepreneurs representing over one million women entrepreneurs and 71 organizations.

My insights today come not as a CPA or tax professional. Rather, they come from women business owners all over the country, women like myself. So, I have first hand knowledge of the tax system from an employer's perspective.

My first observation is that the tax code is outdated. Thanks to advancements in technology, entrepreneurs now have access to world markets without requiring employees to be housed in a central location. You can now work with contractors and employees all over the world. Using "1099" Independent Contractors is no longer a way to skirt the employer obligations, it's the way business is done. Businesses now operate everywhere, including homes and shared office spaces—the workforce is changing, and the entrepreneurial landscape does not look like it did 50 years ago.

My second observation is that the tax code is needlessly complex—especially for small businesses. In 2011 for example, the National Small Business Association found that 64% of small business spent at least a full workweek simply paying their taxes. That is on top of the disproportionate cost small business annually face to pay taxes: approximately 67% more than large companies.[1] Beyond annual filing and compliance, the tax code is equally complex in the formation of a new business. The Internal Revenues Service (IRS) recognizes six different forms of businesses with seven different forms and tax requirements.

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[1] Office of Advocacy, U.S. Small Business Administration (2009). "Effective Federal Income Tax Rates Faced by Small Businesses in the United States." http://www.sba.gov/sites/default/files/rs343.pdf

As the Congress convenes roundtables, holds hearings and drafts legislation to address tax reform and problems such as these, it will be important to keep overarching guidelines to all the changes. We see two such overriding principles with respect to a reformed tax code: (1) make it simple; and (2) make it fair.

Simplicity

We have to make it easier to pay taxes. In WIPP's 2013 Annual Survey, a majority of women business owners said they would forgo tax credits and deductions in exchange for lower tax rates and a simpler tax code. While the current code supports some aspects of entrepreneurship and business creation, too often, entrepreneurs cannot navigate the deduction and credits to claim them. Of the more than 20 tax provisions supporting small businesses, almost all require increased record keeping and often the direction of tax professional. This requires time and money that women entrepreneurs could put to better use.

Starting a business is also made more difficult by the tax code. The different types of business structure (i.e. S-Corp, C-Corp, Sole Proprietorship, L.L.C., etc.) all lead to different tax liabilities. And to file taxes on those liabilities, business owners must navigate seven different IRS forms required for six different business designations. The tax code, whether starting a business or paying annual taxes, can be simpler and in the view of women business owners, it should be.

Fairness

Complimenting the need for simplicity is a principle of fairness. Tax rates for businesses ought to be the same. Tax liability should not depend on how a business is organized, and any tax deduction or credit should be applicable to any form of business. An example of the disparity I hope reform will tackle is the inability of self-employed to deduct health expenses, an option available to other businesses.

Similarly, tax liability should not depend on how many loopholes a tax professional can find—as is currently the case. A recent study from the Government Accountability Office (GAO) noted, profitable American corporations only pay an effective tax rate of 12.6%,[2] a far cry from the statutory 35%, while small businesses operating as S-Corps pay an effective tax rate of nearly 27%.[3] There should not be such a discrepancy of taxation generate solely by our tax code. In our view, business is business.

[2] Government Accountability Office (2013). "Corporate Income Tax: Effective Tax Rates Can Differ Significantly from the Statutory Rate." GAO-13-520. http://www.gao.gov/assets/660/654957.pdf
[3] Office of Advocacy, U.S. Small Business Administration (2009). "Effective Federal Income Tax Rates Faced by Small Businesses in the United States." http://www.sba.gov/sites/default/files/rs343.pdf

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In the event Congress does not create a simple tax rate for all businesses, we believe the following should be considered in any reform:

Addressing Corporate and Individual Reforms Simultaneously

With the nature of pass-through entities and the inextricable link between individual and corporate taxation policy, especially with small businesses, any reform of one tax system must be complemented by reforms to the other. It would be simply unfair to the millions of businesses operating as pass-through entities to lower the corporate tax rate but not correspondingly address the individual tax rate. The opposite is equally true—again, I think reforms should be governed by fairness and equity.

One Time Tax Incentive for New Businesses

The Senate Finance Committee has stated that the tax code should effectively promote important policy objectives. In that vein, it seems to us that giving a one time incentive to individuals to start businesses could remove a barrier to business creation. It would have to be simple, but could be an effective tool to launch new businesses.

Encourage Investment in Small Business

Tax incentives could be used to stimulate investment in small businesses. A number of them exist in today's tax code. We believe a tax break to angel investors, among others, could serve as a catalyst to spur investments under $5 million. We note that Louisiana has such an incentive already in place.

Taxes are at the very core of our business and personal finances—we pay them individually, we pay them as employers, and we pay them as corporations. But among these communities of taxpayers, there is one group that, far and away, faces the toughest burden in both paying and filing taxes—America's small businesses. This Congress has the opportunity to fix that, and WIPP looks forward to being a partner in that effort. Thank you, I look forward to this discussion.

Women Impacting Public Policy (WIPP) is a national nonpartisan public policy organization, advocating on behalf of over 1 million women-owned businesses representing 71 business organizations. WIPP provides timely economic policy information, identifies important trends and opportunities to its membership, and provides a collaborative model for the public and private sectors to increase the economic power of women-owned businesses.

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Senate Committee on Small Business and Entrepreneurship

Small Business Tax Reform: Making the Tax Code Work for Entrepreneurs and Startups

July 17, 2013

Ann Sullivan
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Thank you Chair Landrieu, Ranking Member Risch and Members of the Committee for the opportunity to be a part of this important roundtable.

Taxes are at the very core of our business and personal finances—we pay them individually, we pay them as employers, and we pay them as corporations. But among these communities of taxpayers, there is one group that, far and away, faces the toughest burden in both paying and filing taxes—America's small businesses.

As Congress begins the process of reshaping the tax code, it provides an opportunity to address the changing shape of business and adapting the tax code to the way businesses in this country are formed and operated. Entrepreneurs now have access to world markets due to technology. They no longer need to have employees housed in a central location—they have the ability to work with contractors and employees all over the world. While some companies will seek to grow rapidly, there are many others who are content working as sole proprietors. Some businesses are full time but many provide supplemental income as part time businesses. Many entrepreneurs work out of shared spaces and their homes—no longer the traditional model that the tax code is built around. In fact, there are close to 17 million workers who are considered members of the independent workforce and their average income is $61,000[1]. According to that research, by 2017, 23 million workers in this country will belong to this group, many of whom will be women.

As the face of business is changing, so should government entrepreneurial assistance programs. The same is true for the tax code. We see two overriding principles with respect to the rewrite: (1) is it simple? and (2) is it fair?

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[1] The State of Independence In America, Emergent Research, September 2012: http://www.mbopartners.com/state-of independence/docs/2012MBO_Partners_State_of_Independence_Report.pdf

Small businesses spend 67% more on compliance costs than do their larger counterparts.[2] The tax code is so complex that in order to take advantage of the deductions and credits for small businesses, a business needs to spend a considerable amount of money to take advantage of the 20 or so deductions available to them. We believe that many small businesses leave many of the current tax breaks on the table because they simply do not understand them. Therefore, our first principle is to keep it simple. It is our sense that many women-owned businesses would prefer a lower tax rate in exchange for the current system of deductions and credits.

In fact, when WIPP members were asked, as a part of the 2013 annual survey, if they would support lowering individual and corporate tax rates in exchange for fewer deductions and credits, 57% of members said that they were in support.

Our second principle with respect to tax reform is fairness. Currently, business designations come in many different forms: partnerships, S-corps, C-corps, LLCs and sole-proprietorships. We believe that any business tax deduction or credit should be applicable to any form of business, no matter how it is created. An example is the deductibility of employer contributions to employee health insurance plans that many small businesses owners claim. Unfortunately, that deduction is not available for the self-employed. In our view, business is business.

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The Senate Finance Committee has stated that the tax code should effectively promote important policy objectives. In that vein, it seems to us that giving a one time incentive to individuals to start businesses could remove a barrier to business creation. It would have to be simple, but could be an effective tool to launch new businesses.

Encourage Investment in Small Business

Tax incentives could be used to stimulate investment in small businesses. A number of them exist in today's tax code. We believe a tax break to angel investors, among others, could serve as a catalyst to spur investments under $5 million. We note that Louisiana has such an incentive already in place.

Rewarding Employee Ownership

Businesses with employees who are financially invested in the company's success often produce impressive results. For example, the Employee Stock Ownership Plan (ESOPs) has been a particularly noteworthy incentive. ESOPs have been a valuable option for employees to be rewarded for hard work and to move on after the departure of an owner. Even more

[2] Office of Advocacy, U.S. Small Business Administration

important, they represent another way for small businesses to raise capital. These plans should carry protections to prevent undue risk to employees, but have demonstrated an increase in production and profitability of many small businesses.

Ann Sullivan

Women Impacting Public Policy's advocate in Washington, D.C., Ann Sullivan, is the President of Madison Services Group, Inc. (MSGI), a woman-owned company that provides government relations and business development services to corporate and non-profit clients.

She has many years of government relations experience with the United States Senate and the House of Representatives, serving in key advisory roles. Ms. Sullivan works with the United States Congress, Executive Office, and government agencies to garner national attention for clients' issues. Her expertise includes business development programs, government procurement, healthcare, export development, and tax issues affecting small businesses. MSGI specializes in outreach to the small business community with an emphasis on women-owned and minority businesses.

Ms. Sullivan also serves on James Madison University College of Integrated Science and Technology Executive Advisory Council and the Montgomery County Chamber of Commerce GovConNet Council. In 2010, she received the Enterprising Women of the Year Award from Enterprising Women Magazine.

Sanford Zinman, CPA

Chairman Landrieu, Ranking Member Risch and members of the Committee. Good afternoon. Thank you for inviting me to participate today. I am a Certified Public Accountant and the tax policy chair of the National Conference of CPA Practitioners - (NCCPAP). NCCPAP members serve over one million small businesses and individuals throughout the country.

We are the professionals acting as the CFO's for those small businesses. We clarify confusing rules in the tax code, and answer the questions about employment and sales taxes.

Small business owners often pay a disproportionate amount for legal and tax services. They rely on outside advisors to ensure they are receiving the benefits of available tax credits while guaranteeing they are following the tax code regulations.

Entrepreneurs use various forms of legal entities to offer protections within the law. Often their choice of entity is made by an attorney, not the business owner. The tax code should not be the determining factor for the choice of entity.

Small business owners want a healthy economy, some tax incentives to help them grow their businesses, a tax code that is understandable and a government that allows them to succeed.

I am happy to be here to discuss the issues these small business owners face.

Thank you.

Sanford E. Zinman, CPA, MBA

Sanford E. Zinman, CPA, MBA is the president of Sanford E. Zinman, CPA PC located in White Plains, NY. He is a graduate of Iona College with a Master of Business Administration in Public Accounting and started his own practice in 1983. He is licensed in New York and Connecticut.

Sanford has been in public accounting for more than thirty years and has expertise in compilations and tax. His diversified clientele includes: architectural firms, attorneys, authors, child care providers, construction and real estate developers, insurance professionals, interior designers, medical/dental professionals, restaurants, and retail operations. He provides business and individual tax services and compilation services and well as individual and corporate tax planning and payroll and payroll tax services.

He is a member of the American Institute of Certified Public Accountants and National Conference of CPA Practitioners. He serves as president of the Westchester / Rockland Chapter of the National Conference of CPA Practitioners and is chair of the Tax Committee for NCCPAP. He has previously also testified before the Senate Finance Committee.

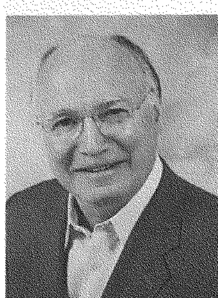
Kristie Arslan
President & CEO
National Association for the Self-Employed

Kristie Arslan is the President & CEO of the National Association for the Self-Employed. Kristie has been with the NASE for the past 10 years, most recently as its Executive Director. With years of advocating on behalf of the self-employed nationwide and her own personal experience working for her family's small business, she provides critical insight into the issues affecting our nation's entrepreneurs.

Arslan's main goal is to provide NASE Members with quality benefits, educational resources and programming to help them achieve their American dream of successful business ownership. Kristie works closely with policymakers in Congress and the Administration and strives to increase the visibility and influence of the NASE to ensure that the self-employed have a seat at the table in Washington D.C.

Currently, Arslan serves on the Board of Directors for the Coalition for Affordable Health Coverage (CAHC) and the Small Business Legislative Council (SBLC). In addition, she is the Chair and founding member of the coalition supporting Equity for Our Nation's Self-Employed. Arslan has been quoted and published in the New York Times, Washington Post, Wall Street Journal, Politico, Roll Call, The Hill and CQ Weekly, and has appeared on MSNBC, FOX, CNBC and C-SPAN. She is also an active blogger on the Huffington Post and Small Business Trends.

A graduate of Lehigh University in Pennsylvania, she also completed a Masters of Public Administration at George Mason University in Fairfax, Virginia.



Mike Eckert
Vice Chairman, Angel Capital Association

Angel Capital Association is comprised of over 200 angel investing groups and near 9,000 individual investors. Mike chairs the ACA's Public Policy Committee. He has extensive start up experiences as a member of the launch team of The Weather Channel/Weather.com where he served as CEO for 14 years. Mike currently resides in New Orleans and is active in the early stage business community there.

Chris Edwards
Director, Tax Policy Studies
Cato Institute

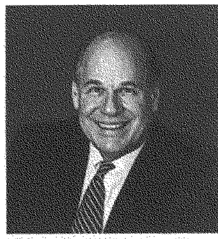
Chris Edwards is the director of tax policy studies at the Cato Institute and a top expert on federal and state tax and budget issues. Before joining Cato in 2001, Edwards was senior economist on the congressional Joint Economic Committee examining tax, budget, and entrepreneurship issues. Previously, he was a consultant and manager with PricewaterhouseCoopers and an economist with the Tax Foundation.
Edwards' articles on tax and budget policies have appeared in the Washington Post, the Wall Street Journal, the Los Angeles Times, Investor's Business Daily, and other newspapers. He is the author of Downsizing the Federal Government and co-author of Global Tax Revolution. He holds a B.A. and M.A. in economics.

Scott A. Hodge
President
Tax Foundation

Scott A. Hodge is president of the Tax Foundation in Washington, D.C., and is recognized as one of Washington's innovative thinkers on tax policy, the federal budget and government spending. Over the past 20 years Scott has been a leader in many successful efforts to change public policy. During the 1990s, he led the campaign to include the $500 per-child credit and capital gains tax cuts in the Contract with America. These tax cuts were the eventual centerpieces of the 1997 tax bill and the Bush tax cuts in 2001 and 2003.

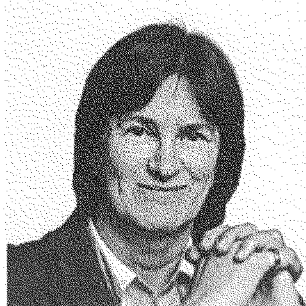
He has been the creative force behind the Tax Foundation's Putting a Face on America's Tax Returns project and the State Business Tax Climate Index, two programs that are changing the terms of the tax debate at the federal and state level. Scott has written and edited three books on the federal budget and streamlining the government and has authored over 100 studies on tax policy and government spending. He has also authored dozens of editorials and opinion pieces for publications such as The Wall Street Journal, The Washington Post, USA Today, The New York Post and The Washington Times. Hodge has conducted over 600 radio and television interviews—including NBC Nightly News, CBS Nightly News, CNN, Fox Network, Hardball with Chris Mathews, and C-SPAN. In addition, he has contributed to stories on wasteful spending aired by ABC's "Prime-Time Live" and "20/20," and NBC's "Fleecing of America."

Before joining the Tax Foundation, Scott was Director of Tax and Budget Policy at Citizens for a Sound Economy. He also spent ten years at The Heritage Foundation, including eight years as Heritage's Grover Hermann Fellow in Federal Budgetary Affairs. Scott began his career in Chicago where he helped found the Heartland Institute in 1984. He holds a degree in political science from the University of Illinois at Chicago.



Michael Keeling
President, The ESOP Association

The ESOP Association is the national trade association for companies with employee stock ownership plans (ESOPs) and the leading voice in America for employee ownership.



Annette Nellen, CPA, Esq.
Director, San Jose State University Graduate Tax Program

Annette Nellen, CPA, Esq., is a professor in and director of San José State University's graduate tax program (MST), teaching courses in tax research, accounting methods, property transactions, state taxation, employment tax, ethics, tax policy, tax reform, and high technology tax issues. Annette has over 25 years of experience in the area of taxation with emphasis on tax policy and reform for the past 18 years.

Annette is a member of the AICPA Tax Reform Task Force, and the immediate past chair of the AICPA Individual Taxation Technical Resource Panel. She a member of the Executive Committee of the Taxation Section of the California Bar. Annette is a regular contributor to the AICPA Tax Insider and Corporate Taxation Insider e-newsletters. Annette was the lead author of the AICPA tax policy concept statement #1, Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals (2001), still in use today.

Annette is the author of Bloomberg BNA Tax Portfolio #533, Amortization of Intangibles. She is also the author of Bloomberg BNA's Legal & Business portfolio, Overview of Internet Taxation Issues.

Annette has testified before the House Ways & Means Committee, Senate Finance Committee, California Assembly Revenue & Taxation Committee, and tax reform commissions and committees on various aspects of federal and state tax reform. She maintains the 21st Century Taxation website and blog (www.21stcenturytaxation.com), as well as several websites on tax reform, state tax nexus and e-commerce taxation.

Prior to joining SJSU, Annette was with Ernst & Young and the IRS.

Greg Nelson
General Manager, Brown Rental Inc.
Boise, Idaho.

Mr. Nelson has owned a number of small businesses but most recently has managed Brown Rental, a construction, tool, and party rental company, since 2005. He is currently in the process of buying the construction and general tool branch of the business. He has been President of Idaho chapter of the American Rental Association since 2011.

William (Bill) Randolph
Director for Business and International Taxation in the Office of Tax Policy
U.S. Treasury Department

Ann Sullivan
President, Madison Services Group, Inc.

Ms. Sullivan is the President of Madison Services Group, Inc., a woman-owned company which provides government relations services to corporate and non-profit clients. She brings many years of government relations experience in the United States Senate and the House of Representatives, serving in key advisory roles. Ms. Sullivan works with the United States Congress as well as the United States government agencies to bring her clients' issues national attention. Her expertise includes government procurement, health care and tax issues affecting small businesses. She currently represents the largest national association of women business owners and women in business, Women Impacting Public Policy. MSGI specializes in outreach to the small business community with an emphasis on women owned and minority businesses.
In addition, Ms. Sullivan founded and heads the International Association for Business and Health (IABH), a nonprofit advocacy group based in Washington, D.C., formed to advance the combined interests of business with the need for quality health care.

In the corporate sector, Ms. Sullivan represented the Fortune 500 natural gas pipelines for the leading natural gas pipeline association in the United States and was at the forefront of government deregulation of the energy industry. As Vice President in a government relations firm, her expertise included environmental issues such as air emissions, water purification, alternative fuel vehicles and energy policy.

Ms. Sullivan possesses six years of experience in the information technology field as the owner of a technical placement services firm serving the Washington and Baltimore metropolitan areas. Ms.

Sullivan has lectured and conducted career transition training in the technology arena for both the public and private sector.

She also serves on the James Madison University College of Integrated Science and Technology Executive Advisory Council.

In March 2010, Ms. Sullivan received the Enterprising Women of the Year Award.

Sanford E. Zinman, CPA, MBA
President, Sanford E. Zinman

Sanford E. Zinman, CPA, MBA is the president of Sanford E. Zinman, CPA PC located in White Plains, NY. He is a graduate of Iona College with a Master of Business Administration in Public Accounting and started his own practice in 1983. He is licensed in New York and Connecticut.
Sanford has been in public accounting for more than thirty years and has expertise in compilations and tax. His diversified clientele includes: architectural firms, attorneys, authors, child care providers, construction and real estate developers, insurance professionals, interior designers, medical/dental professionals, restaurants, and retail operations. He provides business and individual tax services and compilation services and well as individual and corporate tax planning and payroll and payroll tax services.

He is a member of the American Institute of Certified Public Accountants and National Conference of CPA Practitioners. He serves as president of the Westchester / Rockland Chapter of the National Conference of CPA Practitioners and is chair of the Tax Committee for NCCPAP. He has previously also testified before the Senate Finance Committee.

AEO Association for EnterpriseOpportunity
THE VOICE OF MICROBUSINESS

Statement of the Association for Enterprise Opportunity

Before the Senate Committee on Small Business and Entrepreneurship

Small Business Tax Reform:
Making the Tax Code Work for Entrepreneurs and Startups

July 17, 2013

The Association for Enterprise Opportunity (AEO) is pleased to take this opportunity to share its views with the Committee in response to the July 17, 2013 roundtable discussion, entitled "Small Business Tax Reform: Making the Tax Code Work for Entrepreneurs and Startups." On behalf of the nation's nearly 26 million microbusinesses – wholly 20% of the nation's workforce – which contribute $4.9 trillion to the economy and employ more than 31 million people, AEO applauds the Committee for its continued engagement with the microbusiness community.

Why Tax Reform is Necessary

The state of small business (and business in general) today is vastly different from when the tax code was last overhauled in 1986. The very model of employment is changing, especially in the aftermath of the most recent economic recession. More people are taking up the mantle of entrepreneurship and creating their own jobs through self-employment. In fact, according to forthcoming AEO research, more than 19 million people are engaged in what some call the independent workforce.

And yet, both of these groups of individuals – microbusinesses (one to five employees) and the self-employed – are the most burdened by today's complex tax code. Effective tax reform will require that the individual and business tax rates be done in tandem, since just reforming the business tax code would leave the majority of microbusinesses in the cold. The self-employed and most microbusinesses are "pass through" entities and, therefore, file business income on their personal income returns.

To put this into context, according to the U.S. Small Business Administration's Office of Advocacy, businesses like these face compliance costs that are 67% higher than their larger counterparts, often paying up to $1,000 per employee at firms with up to five employees.

Of the 20 or so tax credits and deductions that exist for small businesses, AEO believes many are left unclaimed by microbusinesses because they are either unaware that they exist or they are too complicated to understand. As a result, these businesses end up paying a higher effective tax rate than larger businesses, which have entire tax teams and divisions.

The Corporation for Enterprise Development (CFED), an AEO partner, has found that even those who can afford outside tax advisors often walk away without a clear understanding of their own taxes. In other words, those who need the most help when tax season arrives are least able to navigate the maze that is our tax code.

Recommendations for A Reformed Tax Code that Incentivizes Business Growth

Every dollar that a business owner saves in taxes is another dollar that can be invested into growing his/her business. With the prospect of comprehensive tax reform a tangible reality in this Congress, the opportunity to create a tax code that encourages microbusiness growth and makes it simpler for the smallest of businesses to comply should not be missed.

In general, AEO believes that the self-employed and microbusinesses would prefer simple and straightforward to complex and burdensome – in other words, a lower tax rate instead of the current web of deductions and credits.

There are, however, incentives that merit consideration in any comprehensive tax reform package. The following tax incentives are immensely important to our nation's microbusinesses and directly stimulate business growth.

AEO believes that a one-time deduction for starting a business makes sense. Similar to the current tax code's start-up tax deduction for entrepreneurs, AEO believes that combining a number of existing start-up tax provisions into one simplified deduction would significantly reduce burdens on business creation. Given the barriers that entrepreneurs face, especially those in underserved communities, such an incentive would be an effective tool.

In that same vein, AEO encourages the Committee to consider maintaining the Earned Income Tax Credit (EITC), which is a federal tax credit to low- and moderate-income workers. When EITC exceeds the amount of taxes owed, it results in a tax refund to those who qualify for it. According to CFED, there are nearly 6 million people who qualify for the EITC and use their refund to support a part-time business.

The New Markets Tax Credit (NMTC), which has accounted for more than $36.5 billion in investments in underserved communities since 2000, has been successful. The NMTC tax credit is designed to leverage capital from investors to spur economic development in urban and rural low-income communities via Community Development Financial Institutions (CDFIs), in exchange for tax credits for the investor over a number of years. While not a direct incentive to individual businesses, the NMTC directly assists entrepreneurs by funding business loans and business counseling.

In summary, we applaud the Congress' willingness to undertake the monumental task of rewriting our nation's tax code, which has not seen comprehensive reform in more than 25 years. AEO urges the Congress to focus on keeping the tax code as simple as possible for our nation's smallest businesses, so that they can spend less time on tax compliance and focus on growing their businesses.

ESCA

THE AMERICAN DREAM AT WORK

Statement for the Record

Senate Small Business Committee Roundtable:
Small Business Tax Reform: Making the Tax Code Work for Entrepreneurs and Startups

July 17, 2013

As the Senate Small Business Committee considers important issues related to tax reform, the Employee-Owned S Corporations of America ("ESCA"), on behalf of member companies and their employee-owners, appreciates the opportunity to share our unique concerns and views on why Congress should preserve and protect private employee-ownership through S corporation ESOP companies. Over 15 years since their creation, S ESOPs accomplish exactly what Congress intended them to do: create jobs, generate economic activity and promote retirement savings.

What is an S Corporation ESOP?
A Subchapter S corporation is a business entity that provides flow-through tax treatment to its shareholders. An employee stock ownership plan ("ESOP") is a qualified defined contribution plan that provides a company's workers with retirement savings through their investments in their employer's stock, ***at no cost to the worker.*** ESOPs are regulated by the Employee Retirement Income Security Act ("ERISA") just like pension funds, 401(k) plans, and other qualified retirement plans. Congress authorized the S corporation ESOP structure to encourage and expand retirement savings by giving hundreds of thousands of American workers in all 50 states the opportunity to have equity in the companies where they work.

Data Supports the Tremendous Value S Corporation ESOPs are for Workers and the Economy
In April, Alex Brill, tax advisor to the Simpson-Bowles deficit reduction commission, introduced a new study looking at the "Macroeconomic Impact of S ESOPs on the U.S. Economy." Key findings from this report reveal that:

- **The number of S ESOPs and the level of active participation (number of employee-owners) have more than doubled since 2002.**
- **Total output from S ESOPs and the industries they support is nearly 2 percent of GDP.**
- S ESOPs directly employ 470,000 workers and support nearly a million jobs in all.
- S ESOPs paid $29 billion in labor income to their employees, with $48 billion in additional income for supported jobs.

The new study preceded a 2012 study by Brill that found:

- Employment among surveyed S ESOP firms increased more than 60% from 2001-2011, while the private sector as a whole had flat or negative growth in the same period.
- In the struggling manufacturing industry in particular, the S ESOP structure has buffered against economic adversity and job loss.
- S ESOPs have significantly expanded the pool of US workers who are saving for retirement, while also boosting company productivity – something that has greatly benefited their employee-owners.

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Brill notes that "in the context of the current tax reform debate that seeks to curtail existing tax expenditures in favor of lower statutory rates, policymakers should recognize the evidence in support of S ESOPs and their positive economic contribution."

His study reinforces what earlier economic analysis of S ESOPs has found:

In a 2010 Georgetown University/McDonough School of Business study, two leading tax economists reviewed the performance of a cross-section of S corporation ESOP companies during the recent recession and found that these companies performed better than other companies in job creation, revenue growth, and providing for workers' retirement security.

Specifically, the study found that:

- **Companies that are S corporation ESOPs are proven job-creators, even during tough times.** While overall U.S. private employment in 2008 fell by 2.8%, employment in surveyed S corporation ESOP companies rose by 2%. Meanwhile, 2008 wages per worker in surveyed S corporation ESOP companies rose by 6%, while overall U.S. earnings per worker grew only half that much.

- **S corporation ESOP companies provided substantial and diversified retirement savings for their employee-owners at a time when most comparable companies did not.** Despite the difficult economic climate, surveyed S corporation ESOP companies increased contributions to retirement benefits for employees by 19%, while other U.S. companies increased their contributions to employee retirement accounts by less than 3%.

<u>S Corporation ESOPs Effectively Promote Retirement Savings</u>

At a time when almost 50% of working Americans have no employer-provided retirement savings plan, employee-owners have *at least* one plan wholly funded by their companies, and in most cases, a separate plan outside of the ESOP (such as a 401(k).

A 2008 University of Pennsylvania/Wharton School of Business study found that S corporation ESOPs contribute ***$14 billion in new savings for their workers each year beyond the income they would otherwise have earned,*** and that S corporation ESOPs offer workers greater job stability and increased job satisfaction. The study also found that S corporation ESOPs' higher productivity, profitability, job stability and job growth generate a collective ***$19 billion in economic value that otherwise would not exist.***

The National Center for Employee Ownership ("NCEO") found that S corporation ESOPs are a major force in providing retirement security to workers. A 2005 NCEO survey reported that S corporation employee-owners had ESOP account balances ***three to five times higher than the U.S. average for 401(k) plan participants.*** For S corporation employee-owners nearing retirement, ESOP account balances were ***five to seven times the average.*** Some 80 percent of companies surveyed by NCEO offer their employees more than one qualified retirement plan.

<u>Support for S Corporation ESOPs is Bipartisan</u>

In April, Senators Ben Cardin and Pat Roberts reintroduced bipartisan legislation, S. 742, the *Promotion and Expansion of Private Employee Ownership Act of 2013*, that will:

- ***Encourage owners of S corporations to sell their stock to an ESOP***
- ***Provide additional technical assistance for companies that may be interested in forming an S corporation ESOP***
- ***Protect small businesses that become ESOPs from losing their SBA certification***
- ***Acknowledge the importance of preserving the S corporation ESOP structure in the Internal Revenue Code***

S. 742 currently has 16 cosponsors: 9 Democrats, 1 Independent and 6 Republicans. This group includes Senator Mary Landrieu, Chair of the Small Business Committee and Senator Jim Risch, Ranking Member.

Last Congress, the same bill (S. 1512) had 14 Democrat and 8 Republican cosponsors. Beyond the cosponsorships, we know there is widespread support for employee-ownership and the S corp ESOP model.

ESCA appreciates the Small Business Committee's consideration of the concerns and interests of S corporation ESOPs. We would welcome the opportunity to continue to work with Committee members and staff and hope that you will use us as a resource.

The Employee-Owned S Corporations of America ("ESCA") is the Washington, DC voice for employee-owned S corporations. ESCA's exclusive mission is to advance and protect S corporation ESOPs and the benefits they provide to the employees who own them. These companies have an important story to tell policymakers about the tremendous success of the S ESOP structure in generating long-term retirement savings for working Americans and their families. ESCA provides the vehicle and the voice for these efforts. ESCA represents employee-owners in every state in the nation.

SMALL BUSINESS MAJORITY

July 23, 2013

Senator Mary Landrieu
Chairwoman
Senate Committee on Small Business and Entrepreneurship
428A Russell Senate Office Building
Washington, DC 20510

Dear Senator Landrieu,

We hope this letter finds you well.

Small Business Majority welcomes the opportunity to comment on the small business tax reforms that can accelerate the start-up and growth of small businesses. Lawmakers on both sides of the aisle agree small business owners are the backbone of our economy, which is why it is so critical that positive steps are being proposed to help level the playing field for them. Entrepreneurs have long felt at a disadvantage when it comes to tax policies, and they support targeted policies that would benefit the vast majority of small firms, not those that only benefit a few. Following are our comments on some tax reforms that can help small businesses succeed.

Small business expensing

Small business expensing is an issue which entrepreneurs have shown significant concern over. Small Business Majority's scientific polling found that in 2012, more than eight in 10 entrepreneurs were anxious that the Section 179 deduction limit was set to drop to $25,000 in 2013. While they can be thankful for the one-year extension that stopped that from happening, a temporary fix is not sufficient enough.

In an effort to eliminate uncertainty over this issue for good and give small businesses some cash flow flexibility, a proposal to permanently allow expensing of capital investments up to a quarter of a million dollars would be welcome news for small firms. That's 10 times what the limit is set to fall to in 2014, sans tax reform. Our research found the vast majority of small business owners would like to see the amount of expenses small business can deduct permanently raised to $1 million. While this plan would not set the bar quite that high, it is a step in the right direction that small businesses support.

Start-up costs

In addition to making changes to the Section 179 deduction as discussed above, combining three existing provisions for start-up and organizational expenses into a single provision is applicable to all businesses. In effect, it would double the dollar amount small firms can expense for startup costs. For entrepreneurs just getting their businesses off the ground, that can make a huge difference. Small Business Majority supports this element of the tax proposal because we know from our extensive experience with small and micro-businesses that start-up costs can be a major barrier for entrepreneurs who are otherwise ready to grow and put more Americans back to work.

Cash accounting

It's also crucial to simplify the accounting process for small business owners. We can do this by creating a uniform rule under which all businesses with gross receipts of $10 million or less would be able use the cash method of accounting. In coordinating this rule with the uniform capitalization rules, small businesses would be generally exempt from complex requirements for allocating inventory. This would save them a great deal of time and energy so they can focus more effort on growing their businesses. It's also important to note that sole proprietors would be able to exercise this cash method of accounting regardless of their level of gross receipts. With 21 million self-employed business owners across the United States, this rule could be a boon for the self-employed community.

Business tax returns

Proposals to change due dates for business tax returns, in order to ease tax compliance for small companies, is also something that can be beneficial to small firms. Small business owners often have insufficient time to prepare their tax returns, as the information needed for their tax forms is sometimes not yet available at the time they must file. Because of this, they frequently end up needing to request an extension. By adjusting the dates for when all the different types of businesses must file their taxes—such as partnerships, S corporations and C corporations—entrepreneurs will have more leeway to get organized for future tax seasons, and will still have the option for an extension if they need it.

Partnerships and S corporations

Many business owners organize their companies as partnerships or S Corporations, and although these small businesses may look very similar on the outside, they have quite different sets of rules when it comes to federal taxes. To streamline some of those rules for current business owners and improve the tax system for future businesses as they organize, the proposal lays out two options to reform tax structures for partnerships and S corporations. Each of these options would do a number of things to improve the archaic nature of both tax structures as they currently function. Improvements would range from reducing double taxation of certain business income to cutting down on complications between federal and state tax returns for small businesses organized certain ways.

Thank you for the opportunity to comment on small business tax reform. If you have any questions please contact Rhett Buttle, Vice President, External Affairs, at rbuttle@smallbusinessmajority.org or (202) 828-8357.

Sincerely,

John C. Arensmeyer

John Arensmeyer
Founder and CEO, Small Business Majority

ONE VOICE

Precision Metalforming Association 216-901-8800

NTMA National Tooling & Machining Association 800-248-6862

www.metalworkingadvocate.org

July 25, 2013

The Honorable Mary Landrieu
Chair
Committee on Small Business
U.S. Senate
Washington, D.C. 20510

RE: Tax Reform for all Manufacturers

Dear Chair Landrieu:

Thank you for your leadership over the years of small business manufacturing in America, particularly during the Great Recession when lenders and creditors turned away so many small businesses seeking loans to finance operations.

As you consider submitting comments to the Senate Finance Committee, we ask that you take into account the impact on the National Tooling and Machining Association (NTMA) and Precision Metalforming Association (PMA) who together as part of "One Voice" represent nearly 3,000 metalworking manufacturing companies in the U.S.

One Voice members are small and medium-sized manufacturers averaging roughly 50 employees and are typically classified under the North American Industrial Classification System (NAICS) as 332 (Fabricated Metal Product Manufacturing) and 333 (Machinery Manufacturing). These classifications combined include 80,000 manufacturing establishments with 2.6 million employees. There are 300,000 manufacturing establishments nationwide according to the U.S. Census with approximately 12 million workers.

We believe Congress has an opportunity in tax reform to make all U.S. manufacturers more globally competitive and spur domestic investment in equipment and employees. Many policymakers do not recognize that access to credit and the ability to secure affordable lending rates is connected to tax policy. When small businesses like our members seek credit to purchase a multi-million dollar machine, lenders examine a company's tax liability. A real-world example is a business in Ohio recently told us that without Bonus "Accelerated" Depreciation, they would not have received the line of credit at the lower rate not been able to purchase an additional machine and retain employees in 2012.

As you look at a comprehensive overhaul, we ask that all manufacturers have a similar rate structure regardless of how they are organized. An April 2011 Ernst & Young, LLP report showed that 81% of all manufacturers are structured as pass-through companies and the U.S. Census shows 89.5% of all manufacturing establishments have fewer than 500 employees.

As Congress embarks on this task, it must consider comprehensive tax reform for both C-Corporations and pass-through businesses. Over the years, the code has become so intertwined we do not believe overhauling only one section of the code is possible without causing injury to hundreds of thousands of small businesses. While many expect more losers than winners in this process, small businesses cannot afford to write larger checks so big corporations receive a lower statutory tax rate. It is also important that the two broader business classification categories (generally referred to herein as C-Corporations and pass-throughs) remain unified in their desire for comprehensive reform that does not pit large companies against smaller businesses who in many cases are their suppliers. Roughly, one-third of One Voice members are C-Corporations and the majority of our customers are also typically structured as C-Corps.

We are also concerned about attempts to rely on certain deductions and credits to reduce the effective tax rate for small businesses and pass-throughs to bring them closer to being "on par" with C-Corporations under tax reform. For example, some have cited using an expanded Section 179 Equipment Expensing provision to help small businesses reduce their tax burden. However, if a business is not purchasing equipment, it will not benefit from the Section 179 and will pay a higher effective tax rate leaving less money in the business to grow in other areas and hire employees.

As demonstrated by the April 2011 Ernst & Young, LLP study, 81% of all manufacturers are structured as pass-throughs. In December 2012, One Voice surveyed both NTMA and PMA members who collectively reported 68% of our members are structured as pass-throughs broken down as follows:

- S-Corporation – 58%
- Limited Liability Corp – 7%
- ESOP – 2%
- Sole Proprietor – 1%

The current C-Corporation portion of the tax code creates numerous roadblocks for a business owner who is either transferring the company to a new generation or selling it to new owners – whether inside the family or outside. The tax code should encourage businesses to continue domestic operations and, when possible, pass it along to the next generation of manufacturers.

The double taxation of C-Corporation dividends, which the owners pay when they take their earnings out of the business, is among the greatest barriers to improving the global competitiveness of manufacturing in America, regardless of their corporate structure. When the owner pays a higher tax rate, it means the company is paying more in taxes and has less to buy equipment and hire employees. In addition, what many people do not know is a small business owner has to personally guarantee loans for the company when buying equipment which can cost in the millions – the fewer resources a business has available to show creditors, the more difficult it is to obtain financing to expand.

While each one of our member companies has different operations manufacturing products for a variety of industries, there are several core tax provisions used by our members to improve their global competitiveness. Based on a December 2012 survey of the National Tooling and Machining

Association and Precision Metalforming Association, respondents identified using the following tax credits and deductions:

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

Capital Equipment Expensing/Depreciation

In the December 2012 One Voice survey, 89% of respondents claimed Section 179 Equipment Expensing while 88% used Bonus "Accelerated" Depreciation. Our members are overwhelmingly maxing out their Section 179 deduction, even under the expanded temporary provision, and then still turn to accelerated depreciation to support their investments in the company. A manufacturer of components for the tractor-trailer and automotive industries recently reported their intention to purchase a $7 million stamping press to help them meet anticipated expansion in 2014.

In an example from 2011, a One Voice manufacturing company reported claiming $400,000 in Section 179 Equipment Deduction. However, at the time the company was making its next major business decision in 2012, the Section 179 limit was $139,000 with a phase out if you purchased more than $560,000 in equipment. The manufacturer needed a machine that cost $611,000 but purchasing this single piece of equipment meant losing the Section 179 deduction because it exceeded the phase out provision. The manufacturer only purchased $130,000 worth of smaller equipment to stay within the threshold of the tax provision only to see Congress extend an expanded Section 179 at the end of the year.

Section 199 Domestic Production Activities Deduction

The Section 199 Domestic Production Activities Deduction is one of the few provisions in the tax code which directly incentivizes manufacturing in America. Nearly half of One Voice members claim the Section 199 which amounts to an effective three percent rate reduction for most domestic manufacturers. This provision directly makes profitable manufacturers more competitive and frees ups resources to invest back into the business. We believe, as referenced earlier by the manufacturing jobs multiplier effect, this industry generates more economic output than virtually any other does.

Research & Development Tax Credit (R&D)

In the December 2012 One Voice survey of its manufacturing members, 41% reported using the R&D Credit down from 53% in 2011. This is a troubling sign that prompted our associations to look further into the reason for the decline in reported usage of the R&D Credit. Increasingly, the smallest of manufacturers believe it is not worth the effort, resources, and potential audit to claim the credit if it is not sizeable enough. Small businesses, regardless of the sector, typically lack the in-house accounting department resources that much larger firms have to help them navigate the red tape associated with the credit.

The more likely reason small manufacturers are not claiming the R&D Tax Credit is that increasingly the businesses and their owners are captured under the Alternative Minimum Tax (AMT). Under current law, those subject to the AMT cannot claim the R&D Tax Credit. According to the Tax Policy Center, "for the typical manufacturing firm, gross receipts and deductions are 10 to 20 times larger than its net income. A 5 to 10 percent change in includable receipts or allowable deductions is sufficient to create an AMT liability."

Last-In-First-Out (LIFO) inventory valuation

To certain manufacturers, there are accounting practices which, if reversed, could have a devastating effect on a company. Switching from Last-in-First-out (LIFO) to a First-in-First-out (FIFO) accounting method could cost a small manufacturer millions, or worse, the business. Among One Voice manufacturing members, 34% reported using the LIFO method in 2012.

However, this statistic is misleading because for those companies who utilize LIFO it has a six and seven figure impact. A One Voice member company reported accumulating over $4 million in LIFO reserves built up over the past 18 years and facing a potential $400,000 tax liability if Congress enacts certain LIFO repeal proposals. Not only does LIFO directly affect our businesses, many raw material suppliers, particularly steel/metal service centers, rely on LIFO. A repeal of this provision will have significant impact on the price of the steel and raw materials we purchase, which in the case of some metalstampers accounts for 70% of their input costs.

Interest Charge Domestic International Sales Corporation (IC-DISC)

Increasingly, small and medium-sized manufacturers are looking overseas for new business opportunities. In the One Voice December 2012 survey, 46% of members report they directly exported their product overseas last year. Further, 83% are indirect exporters who ship their manufactured product to a customer who then exports an assembled good.

As businesses continue to grow their exports, tax provisions such as the Interest Charge Domestic International Sales Corporation (IC-DISC) have helped manufacturers reach new markets and expand their businesses.

Net Operating Loss (NOL)

The Great Recession devastated the manufacturing industry which lost millions of jobs over the past decade. While most policymakers may assume the worst is behind us, countless manufacturers remain under the Net Operating Loss (NOL) carry forward provisions. Many One Voice members privately report that the NOL literally saved their companies and allowed them to continue their operations and retain manufacturing employees. While business conditions are improving, the economy has a long way to go before a full recovery and the NOL is an important provision which helped manufacturers weather the Great Recession.

Thank you for years of support of small businesses and your consideration of these comments as Congress works towards an overhaul of the tax code. We look forward to continuing to work with you.

Sincerely,

Dave Tilstone
NTMA President

William E. Gaskin
PMA President

NATIONAL RESTAURANT ASSOCIATION

July 24, 2013

The Honorable Mary Landrieu
Chair, Committee on Small Business and Entrepreneurship
428 Russell Senate Office Building
Washington, DC 20510

Dear Chairwoman Landrieu:

On behalf of the National Restaurant Association (the association), we would like to share our thoughts on tax reform and particular issues affecting the food service industry for your consideration. You have been a long-time champion and effective leader on small business issues and an important friend to the restaurant industry. As you know, on June 27, 2013, Senate Finance Committee Chairman Max Baucus and Ranking Member Orrin Hatch asked their colleagues for ideas on how to reform our tax code. We hope you will help us make the Finance Committee aware of tax policies that are important to our industry.

Currently, the tax law presents taxpayers with a great deal of complexity, unpredictability and compliance burdens. The association believes tax reform offers an opportunity to provide taxpayers with certainty, simplicity, and fairness, while also encouraging economic growth and job creation. If done properly, a comprehensive and nuanced review of the tax system would eliminate those tax policies that detract from these objectives, while promoting those that advance them.

The association has been working for the past several years to make the case for fair reforms that take the restaurant industry's organizational diversity into account. We believe that marginal tax rates for both individuals and corporations should be reduced as much as possible. We also believe it is important for Congress to examine corporate and individual tax reform simultaneously due to the variety of smaller pass-through entities that make up the majority of restaurant businesses. Moreover, as the Congress moves forward with crafting reform legislation, we would like to highlight several provisions of particular importance to the food service industry. Specifically, we strongly support:

1) Making permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements. This temporary provision clearly comports with the tax reform policy that cost recovery reflect the economic useful life of the taxpayer's investment.
2) Making permanent the Work Opportunity Tax Credit ("WOTC"). WOTC has been very effective helping targeted group members find gainful employment.
3) Retention of the FICA tip credit which has been instrumental to enhancing compliance and the accurate reporting of tip income.

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4) Making permanent for all restaurant businesses the enhanced charitable deduction for donations of food inventory, which has helped alleviate hunger in the U.S.
5) Restoring the business meal deduction to better reflect the basic principle that business expenses should be fully deductible.

Restaurants: An Industry with a Large Impact on Our Nation's Economy

The restaurant industry plays a significant role in our nation's economy. In 2013, the restaurant industry is expected to reach a record high of $660.5 billion in sales, representing 4 percent of the U.S. gross domestic product. Every dollar spent in restaurants generates an additional $2.05 spent in our nation's economy. The restaurant industry is one of the nation's largest private job creators and is expected to employ approximately 13.1 million people in 2013, representing nearly ten percent of the U.S. workforce. The restaurant industry is expected to add 1.3 million jobs over the next decade reaching 14.4 million by 2023. The restaurant industry job growth outpaced the overall economy in 13 consecutive years, from 2000 to 2012. Average sales in 2010 were $849,000 at a full-service restaurant and $753,000 at a quick-service restaurant. We are truly one of the cornerstones of this nation's economy.

It is also important to stress that the restaurant industry is an industry of small businesses. There are 980,000 restaurant and foodservice outlets in this country. Ninety-three percent of eating and drinking place businesses have fewer than 50 employees and more than seven out of 10 are single-unit operations. In addition, restaurants serve as the conference rooms for many of the self-employed and other small businesses.

Accordingly, as the Congress undertakes its review of the tax code, the association believes it is important to examine corporate and individual tax reform simultaneously due to the restaurant industry's organizational diversity. Since a variety of smaller pass-through entities make up a majority of restaurant businesses, only through comprehensive reform can a truly fair outcome be achieved.

As mentioned above, there are several specific provisions contained in the tax code that directly affect the food service industry and are a priority for the association. We hope you will take these comments into consideration as the deliberations on tax reform continue.

Permanence of the 15-year Depreciation Schedule for Leasehold Improvements, Restaurant Improvements and New Construction, and Retail Improvements

One principle of the tax code is that the cost of assets are allocated over the period in which they are used. Assets with longer expected lives are depreciated over a longer period of time, while assets with shorter lives are depreciated over a shorter period of time. As a reflection of this principle, the tax code contains a provision under which leasehold improvements, restaurant improvements and new restaurant construction, and retail improvements can be depreciated over 15 years rather than a 39-year recovery period that would otherwise apply to nonresidential real property.

With more than 130 million Americans patronizing restaurants each day, restaurant building structures experience daily structural and cosmetic wear and tear caused by customers and employees. Moreover, National Restaurant Association research shows that most franchise contracts require restaurant owners to remodel and update their building structures every six to eight years. Consequently, 15 years is a more accurate timeframe for recovering the cost of investments in restaurant buildings and improvements.

Moreover, a 15-year depreciation schedule reduces the cost of capital expenditures and increases cash flow. As demonstrated in Figure 1 below, the annual tax savings and corresponding additional cash flow realized by restaurateurs from a 15-year, rather than a 39-year, depreciation schedule are considerable. For example, a restaurateur's annual tax liability would increase by nearly $10,000 if the recovery period for a $1 million investment were increased from 15 years to 39 years. A more accurate recovery period frees resources to expand business either through new hires or further capital expenditures.

Figure 1.

Sample Calculations for 15-Year versus 39-Year Depreciation

Total Capital Expenditure on Eligible Property	Annual Depreciation Based on 39-year Schedule	Annual Tax Savings from Depreciation	Annual Depreciation Based on 15-year Schedule	Annual Tax Savings from Depreciation	Annual Difference in Tax Savings Between 15- & 39-year Schedules
$100,000	$2,532	$608	$6,667	$1,600	$992
$250,000	$6,329	$1,519	$16,667	$4,000	$2,481
$500,000	$12,658	$3,038	$33,333	$8,000	$4,962
$700,000	$17,722	$4,253	$46,667	$11,200	$6,947
$1,000,000	$25,316	$6,076	$66,667	$16,000	$9,924
$1,500,000	$37,975	$9,114	$100,000	$24,000	$14,886
$2,000,000	$50,633	$12,152	$133,333	$32,000	$19,848

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

Additionally, when restaurants invest in construction and renovations, the impact spreads throughout the economy. Figure 2 (attached at the end of statement) provides state-by-state estimates of the additional spending on restaurant improvements and new construction that would result from an extension of the 15-year depreciation provision in 2013, as well as the overall economic and employment impact within each state.

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However, the 15-year depreciation schedule is temporary and must be extended annually. Most recently, it was extended by the *American Taxpayer Relief Act of 2012* retroactive to the beginning of 2012 and through the end of 2013. Consequently, the provision will expire again at the end of this year unless Congress takes action. The piecemeal and temporary approach to the 15-year depreciation schedule, requiring extension every couple of years, presents taxpayers with unnecessary uncertainty and complexity.

In March 2012, we surveyed a sample of nearly 600 restaurant operators who took advantage of the 15-year depreciation provisions between 2005 and 2011. The survey revealed that 30 percent of restaurant operators said they put projects on hold in 2012 when the provision lapsed because of the uncertainty surrounding the extension of the 15-year depreciation provision. With single-unit restaurant operators reporting an average expected project cost of $40,000, and multi-unit operators reporting an average expected project cost of $500,000, the additional construction activity from these restaurant projects put on hold would have exceeded $7 billion in 2012. Based on economic multipliers from the Bureau of Economic Analysis, the overall economic impact of these restaurant construction projects would have exceeded $23 billion, with a total employment impact of nearly 200,000 additional jobs across all U.S. industries.

Using tax reform to make permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements would address this problem, providing taxpayers with predictability, simplicity, and fairness. The ability to plan for these expenditures and know what the tax treatment will be in the future is important to those who are making business decisions in today's economy.

Permanence of the Work Opportunity Tax Credit

Another important provision in the tax code is WOTC, a tax credit provided to employers who hire individuals from several targeted groups who face significant barriers to employment. Examples of WOTC-targeted employee groups include veterans who either are Supplemental Nutrition Assistance Program ("SNAP", formerly food stamps) recipients or are unemployed and suffering a service-connected disability, former felons, disconnected youth, and members of families receiving benefits under the Temporary Assistance for Needy Families Program ("TANF").

The restaurant industry employs over 13 million people, many of whom may not have been hired if WOTC had not been in place. WOTC encourages employers to hire certain categories of individuals with barriers to employment, enabling these workers to move into self-sufficiency as they earn a steady income and become contributing taxpayers. Through WOTC, more long-term welfare recipients – the most difficult cases – are being

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employed in the private sector and seven out of 10 welfare recipients are using WOTC to help find private sector jobs. A 2011 study by Peter Cappelli of the Wharton Business School at the University of Pennsylvania found that individuals hired under WOTC go on to become productive employees who are no longer dependent on public assistance.

Further, WOTC works. In 2011, more that 1.1 million workers found jobs through WOTC, at an average cost of approximately $1,300 based on Joint Committee on Taxation data. It is important to note that this figure does not reflect any offsetting savings from lower welfare, disability, and social security payments. The Cappelli study found that WOTC is one of the most successful and cost effective federal employment programs.

WOTC was most recently extended by the *American Taxpayer Relief Act of 2012* retroactive to the beginning of 2012 and through the end of 2013. Consequently, the provision will expire again at the end of this year unless Congress takes action. Allowing this provision to expire again at a time of intransigent unemployment would be a significant setback for job creation. Congress should make WOTC permanent, since it has proven to be an efficient incentive for businesses to provide jobs for workers who might otherwise fall through the cracks. Doing so would further provide taxpayers with predictability and certainty in the tax code.

Retention of the FICA Tip Credit Reimbursement

The FICA Tax Tip Credit Reimbursement, codified in Section 45B of the tax code, is a reimbursement for the food and beverage employers' portion of FICA taxes on reported tip income above the minimum wage. That reimbursement is, in effect, an intermediary fee for encouraging tip reporting and helping the IRS collect employment and income taxes owed by employees on their tips.

Restaurant servers and bartenders are required to report tips to their employers. The employers in turn base income tax withholding and payment of FICA taxes on this information. FICA taxes are a Federal payroll tax imposed on both the employees and employers to fund Social Security and Medicare. Employers withhold and deposit employees' FICA taxes on all regular wages and reported tip income. Employers also pay upfront the employer share of FICA taxes on employees' wages and tip income, even though tips are a third-party transaction between the guest and the tipped employee dependent solely on the level of service.

The credit for employer-paid FICA taxes on tips originated with the *Omnibus Budget Reconciliation Act of 1993* (P.L. 101-508). Ways and Means Committee Chairman Bill Archer (R-TX), who was on the Committee when the reimbursement was created, explained that "the FICA tax tip credit is unique from other credits – rather than a subsidy, it is an integrated component of the requirement that employers pay FICA taxes on deemed

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employee tip income." Section 45B does double duty by encouraging accurate reporting of tips for both FICA tax and income tax purposes and helps to ensure accurate Social Security benefits for tipped workers.

Former Ways and Means Committee Member Barbara Kennelly (D-CT) also on the Committee when the reimbursement was created, said, "with so many seniors dependent on the system, it is critical that low-income workers, such as Food and Beverage workers, fully pay into Social Security during their working years."

It is difficult to know exactly how much tip reporting would fall absent the credit, but tracking the impact of the enactment of Section 45B in 1993 showed it clearly led to greater tip reporting at the source and better tax compliance. Total tip income reported to the IRS increased substantially, from $8.5 billion in 1994 to $14.3 billion in 1999. Because the 45B tax credit has been successful in boosting tax compliance, we urge its retention.

Permanence for the Deduction for Charitable Donations of Food Inventory for Small Businesses

Each day, 35 million Americans are at risk of hunger. At the same time, billions of pounds of food are wasted each year. America's restaurants give back to their communities in major ways, the most significant of which is through food donation. According to National Restaurant Association research, 73 percent of restaurants donate food to individuals or charities.

The deduction for charitable donation of food inventory is a critical tool in alleviating hunger. Without the provision, taxpayers get the same tax treatment for throwing out surplus food as they do for giving it to charity. The enhanced deduction instead encourages donating the food to charity, by helping to offset the costs associated with storing and transporting the extra food. Absent the enhanced deduction for the charitable donation of food inventory, these charities would be hard-pressed to meet critical demands, putting our nation's most vulnerable families at risk for hunger.

However, the impact of the deduction could be improved. For nearly 30 years since its inception in 1976, the tax deduction for contributions of food inventory was limited to C corporations. In 2005, the provision was temporarily expanded to include pass-through entities (i.e., Subchapter S corporations, limited liability companies) and has been extended on subsequent occasions; most recently it was part of the *American Taxpayer Relief Act of 2012.* Making permanent the now-temporary component of the deduction would make it more effective, while advancing the objectives of providing taxpayers with simplicity and predictability.

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The National Restaurant Association strongly encourages its members to donate more food and has partnered with Food Donation Connection ("FDC") to strengthen this effort. Founded by a former restaurant executive, FDC serves as the liaison between the restaurants interested in donating food and the social service agencies adept at getting that food to people in need. FDC helps restaurants develop and implement programs designed to provide an alternative to discarding surplus food while capitalizing on the economic benefits of those donations through the tax savings. Since 1992, FDC has helped facilitate the donation of over 210 million pounds of food to non-profit, hunger-relief agencies.

We urge the retention of the enhanced deduction for donations of food inventory. We also urge Congress to make permanent the temporary provision allowing unincorporated small businesses the same enhanced deduction for food donations.

Restoring the Business Meals Deduction

The association supports tax reform that would restore the full deduction for business meals and entertainment expenses. Under current law, the business meal and entertainment deduction is limited to only 50 percent of costs incurred. By way of background, business meals previously were fully deductible. In 1986, the deduction was reduced to 80 percent and, in 1993, the deduction was further reduced to its current level of 50 percent.

The business meal deduction should be reformed to better reflect the basic principle that business expenses should be fully deductible. Full deductibility would appropriately bring the business meal deduction in line with other ordinary and necessary business expenses, but even increasing the limitation back to 80 percent would better align the provision with these objectives.

According to National Restaurant Association research, increasing the business meal deduction to 100 percent would increase business meal sales by $14.2 billion and create an additional 352,000 jobs. Increasing the business meal deduction to 80 percent would increase business meal sales by $7.9 billion and create an additional 195,000 jobs. Moreover, restaurants service more than 130 million guests every day and the overall impact to the economy of full deductibility or a return to 80 percent deductibility of business meals would be significant. Each dollar spent dining out generates $2.05 in business to other industries, totaling more than $1.7 trillion in overall economic impact.

More importantly, at a time when the country is getting back on stronger economic footing, this reform measure is particularly critical especially for the small businesses and self-employed individuals that depend so heavily on business meals to conduct business. Small businesses often use restaurants as "conference space" to conduct meetings or close deals. Meals are their best, and sometimes only, marketing tool. Certainly, an increase in the meal and entertainment deduction would have a significant impact on a small business's bottom line.

Conclusion

On behalf of the National Restaurant Association, thank you for the opportunity to share our views on tax reform. We applaud the commitment of policy makers to make the tax code more certain, fairer, simpler while encouraging economic growth and job creation. As the Congress forward with its deliberations, we look forward to working with you and would be pleased to serve as a resource. If you have any questions, please feel free to contact me at 202-331-5905 (dkoenig@restaurant.org).

Sincerely,

David G. Koenig

David G. Koenig
Vice President, Tax & Profitability
National Restaurant Association

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Figure 2.

Estimated Impact of Extending 15-Year Restaurant Depreciation Provision Through 2013

State	Increase in Spending on Restaurant Improvements & New Construction (in millions)	Total Economic Impact Within the State (in millions)	Total Employment Impact Within the State (total jobs in all industries)
Alabama	$78	$170	1,591
Alaska	$21	$37	263
Arizona	$113	$233	1,913
Arkansas	$53	$104	961
California	$851	$1,953	13,122
Colorado	$130	$293	2,264
Connecticut	$101	$192	1,250
Delaware	$22	$41	269
District of Columbia	$26	$31	42
Florida	$380	$785	7,054
Georgia	$194	$441	3,818
Hawaii	$42	$80	609
Idaho	$40	$71	718
Illinois	$312	$728	4,870
Indiana	$134	$294	2,381
Iowa	$81	$144	1,293
Kansas	$60	$115	900
Kentucky	$75	$161	1,406
Louisiana	$87	$182	1,518
Maine	$42	$82	834
Maryland	$129	$250	1,758
Massachusetts	$193	$382	2,474
Michigan	$224	$482	4,051
Minnesota	$118	$251	1,957
Mississippi	$47	$94	872
Missouri	$127	$275	2,145
Montana	$39	$73	748
Nebraska	$48	$80	723
Nevada	$58	$109	801
New Hampshire	$39	$78	586
New Jersey	$254	$550	3,468
New Mexico	$37	$71	659
New York	$595	$1,075	7,049
North Carolina	$190	$391	3,665
North Dakota	$22	$38	307
Ohio	$254	$584	4,840
Oklahoma	$70	$150	1,424
Oregon	$117	$241	2,018
Pennsylvania	$330	$781	5,728
Rhode Island	$39	$71	539
South Carolina	$98	$214	2,016
South Dakota	$25	$42	416
Tennessee	$109	$246	2,035
Texas	$427	$1,068	8,210
Utah	$48	$112	1,012
Vermont	$21	$39	384
Virginia	$166	$345	2,645
Washington	$187	$408	3,010
West Virginia	$38	$73	627
Wisconsin	$173	$362	3,036
Wyoming	$17	$29	241
United States	$7,081	$23,944	199,830

Source: National Restaurant Association estimates, with economic and employment impact based on BEA multipliers

Note: State impact figures do not sum to the U.S. total, because they only include inputs within each state.

CompTIA

U. S. Senate Committee on Small Business and Entrepreneurship

Small Business Tax Reform

July 17, 2013

Smart Tax Reforms for the IT Industry

Overview

Tax burdens and compliance costs consistently force small and medium-sized (SMB) information technology (IT) companies to divert needed resources away from their core businesses, restricting growth and innovation. Reducing the financial burden on these firms via tax reform would promote additional growth and opportunities for the SMB IT industry, and eliminate hurdles within the tax code that are limiting the industry's ability to remain globally competitive.

While the SMB IT industry strongly supports closing unfair loopholes and outdated deductions as a means of increasing revenue for broader reforms, there are several key tax provisions that incentivize growth and innovation. Removing these provisions would significantly hamstring SMB IT's ability to grow and strengthen the economy.

This testimony provides an overview of the industry and highlights the key tax policies for the IT industry within four tax reform principles:

1. Simplify the tax code.
2. Reduce the tax burden on the SMB IT industry.
3. Incentivize growth and innovation.
4. Protect SMB IT from new interstate tax compliance burdens.

The data compiled for this report are largely the result of an annual survey CompTIA conducts of its members.

A Vital Contributor to the Economy

The IT industry in the United States remains a vital contributor to the domestic economy. Currently, the industry comprises about 26 percent (or $950 billion) of the $3.6 trillion global industry. Through innovation and growth, domestic IT firms have remained globally competitive and economically strong. SMBs within the IT industry employ some 1.8 million workers, while spending approximately $110 billion annually on payroll. Generally, these are high-paying jobs that rely on skilled workers who continually adjust their skills to meet market trends.

Moreover, within this category, many companies operate within what is referred to as the IT channel. The IT channel spans the IT marketplace between the vendor and the end-user and forms a bridge between distributors, resellers, integrators and consultants. Seventy-five percent of all IT products and services, representing more than $350 billion, are sold to businesses through the channel as opposed to through retailers or direct sales. The vast majority of IT firms in the channel are small and medium-sized enterprises.

Although the industry remains strong, there is significant potential for additional growth. According to January 2013 statistics from Indeed.com, more than 265,000 IT-related jobs are currently available. While this reflects a clear skills gap among potential employees, it also highlights the current job growth in IT firms.

While a range of policies may impact the state of the industry, few have a larger impact than the current tax code. Despite good intentions, too many outdated or unfair policies have proven to hamstring growth within the industry. Given the impact that SMB IT business has on the economy, ensuring the tax code promotes growth for domestic IT should be a key goal in any tax reform efforts.

Principle 1: Simplify the Tax Code

The tax code has continued to become increasingly complex and complicated, especially for SMB IT companies that do not have the resources to maintain large internal accounting and legal departments. As the tax code has grown, the cost of compliance (and potential for errors) has increased rapidly. Both sides of the political aisle have identified the need to simplify the tax code as a key priority.

A recent CompTIA survey found that 48 percent of IT executives identify complexity and the burdens associated with managing taxes as their primary concern with U.S. tax policy. Further, the survey found payroll tax filings to be the most costly and complicated tax requirements for businesses.

As the chart indicates, the SMB IT industry has identified a number of tax provisions that would clearly benefit from reforms that reduce the complexity of the tax code. CompTIA recommends the following:

- **Payroll Tax Filing Simplification:** Employers are generally required to file Form 941 on a quarterly basis to report and pay federal income tax withholdings, social security and Medicare tax. Very small employers with an annual liability of $1,000 or less are allowed to replace these quarterly filings with a single annual Form 944. Increasing this $1,000 threshold would allow more small businesses to file annually instead of quarterly, which would significantly reduce the cost of compliance and risk of error. CompTIA recommends increasing this threshold to $50,000, which will provide compliance burden relief for the majority of the 5.8 million* small businesses employing 1-99 employees. This proposal presumes that the tax deposit requirements remain unchanged; only the requirement of filing a quarterly return would be changed to allow one annual return.

  **According to the 2008 U.S. Census, there were a total of 5,821,277 small businesses employing approximately 42 million employees with an annual payroll of over $1.5 trillion.*

Principle 2: Reduce the Tax Burden on the SMB IT Industry

According to the U.S. Economic Census, 67 percent of IT services firms, including employer and non-employer businesses, pay taxes at individual rates as a sole proprietor or pass-through entity. Therefore, it is important that tax reform does not adversely affect these small businesses. While a corporate tax rate reduction remains very popular among SMB IT companies (63 percent believe it would be an important policy), the direct impact to pass-through entities would be tangential. However, the economic implications of a corporate tax rate reduction (and its impact on adjacent industries) would likely have a positive impact on SMB IT companies depending on the broader tax policies adopted.

We also note that SMB IT companies cite a reduction in payroll tax as a top issue. While income tax liability might fluctuate, virtually all of the SMB IT industry must pay payroll taxes, associated with its $110 billion annual payroll. The most direct way to lessen the burden on these businesses is to provide a reduction in the employer's share of these taxes. This would make it easier and less costly to add new workers.

As the chart indicates, reducing the current tax burden on SMB IT is an important priority for the IT industry. CompTIA recommends the following:

- **Top-Line Tax Reduction:** Within comprehensive tax reform, a variety of tax provisions, including a corporate tax rate reduction, will be on the table. While the IT industry may be impacted to varying degrees depending on the combination of the various reductions, it is important that any solution provide comparable rate reduction for entities that are sole proprietors and pass-through entities. Ignoring these important economic engines – by simply reducing the corporate tax rate alone – would continue to hamstring the ability of the SMB IT to grow and prosper. We also recommend a reduction in the employer's share of payroll taxes; this will encourage businesses to hire more workers, which will in turn lead to economic growth for our nation.

Principle 3: Incentivize Growth and Innovation

The SMB IT industry relies on its ability to grow and remain innovative. Many of the largest IT companies in the U.S. started as small businesses that succeeded through constant innovation and investment. Unfortunately, many of these small start-up IT firms are economically unable to continue to make these innovation investments.

The SMB IT industry believes the tax reform debate must include discussion of all tax provisions. In fact, executives surveyed indicated that certain deductions and loopholes were a major issue impacting tax policy. However, there are a number of tax benefits that are meaningful to economic growth and provide a pathway to innovation for the SMB IT industry.

CompTIA recommends the following:

- **R&E Tax Credit for Small Businesses:** Most small start-up companies do not show a profit, and thus do not have an income tax liability against which to offset the traditional R&E tax credit. Therefore, some of the most vital and innovative companies cannot receive any economic benefit from the traditional R&E tax credit. Accordingly, CompTIA *supports S. 193, the "Startup Innovation Credit Act of 2013"* that would allow start-up companies to offset any R&E tax credit against payroll tax liability.

- **Bonus Depreciation:** Bonus depreciation promotes investment and growth by businesses and has been especially important to small businesses. While the economy is improving, small businesses need continuing support to grow their businesses. For 2011 and 2012, businesses were allowed an additional 100 percent bonus depreciation. This limitation has been extended through 2013, but will expire beginning in 2014. CompTIA calls on Congress to permanently extend bonus depreciation at the 100-percent level.

- **Small Business Expensing:** Section 179 allows small businesses to deduct the cost of certain asset purchases, as opposed to requiring the cost to be capitalized and depreciated over a period of years. This enables small businesses to invest in technologies that improve both productivity and the quality of goods and services. The current limitation of $500,000 per year will drop to $25,000 after 2013. CompTIA strongly supports a permanent extension of the $500,000 limitation.

Principle 4: Protect SMB IT from New Interstate Tax Compliance Burdens

As state budgets face ever-increasing pressures to raise revenues, state tax authorities must become more creative in their collection efforts. While states should not be limited in their ability to tax transactions within their jurisdiction, it is important that this emerging regime of taxation not unfairly impact the IT and tech industries, especially SMBs. Additionally, it is important that new state tax laws do not create unfair and duplicative taxes on SMB IT companies, imposing additional compliance costs on sellers and their customers. Therefore, CompTIA recommends:

- **Small Business Exemption for Sales and Use Taxes:** For any legislation that would require out-of-state sellers to collect and remit sales taxes, CompTIA supports a robust small business exemption. Small businesses are less capable of bearing the costs of a new tax compliance requirement. CompTIA believes the debate should be refocused to balance the rights of states to collect sales taxes with the ability of small businesses to cover these new compliance costs. States have a right to collect sales and use taxes owed, but the costs associated with shifting this compliance burden onto small businesses also must be weighed. Small businesses that provide goods and services remotely are as vital to our economy as those small businesses that reside in and make sales within a single state.

- **Digital Download Taxation:** Consumers, vendors and taxing authorities need a consistent rule to determine which state/ jurisdiction is permitted to impose a tax on the purchase of a digital product or service. Currently, there is no certainty concerning which jurisdiction has the authority to tax these products among the location of the customer, seller's server and customer's home address. This creates the potential for multiple and discriminatory taxes on the purchase of digital goods and services. Therefore, CompTIA supports proposals that would restrict collection of sales taxes on digital goods and services to the jurisdiction encompassing the consumer's tax address, while also prohibiting multiple and discriminatory taxes. We believe this is a simple and objective criterion that will bring both certainty and lower compliance costs for taxpayers, vendors and taxing authorities.

- **Business Activity Taxation:** While *physical nexus* (having an office or place of business in the state, or employing workers that operate within the state) continues to control sales and use tax collections, some states now are seeking to tax any transaction that has an "economic nexus" to that state. CompTIA supports enactment of a distinct physical presence requirement as a prerequisite for the taxation of business activities. That is, states should not be permitted to tax businesses that do not have a physical presence or workforce within that state. Permitting states to reach out to impose tax collections and reporting on non-resident small businesses that have no contact with that state would impose an unaffordable compliance burden, especially on the SMB IT industry.

Conclusion

Tax reform should be a mechanism to promote additional growth and opportunity for small businesses. For the SMB IT industry, its strength relies on its ability to grow, innovate and adjust to market trends. SMB IT companies across the nation are providing services to all major industries from healthcare to agriculture. The success of these industries relies on the IT industry and the services they provide.

The U.S. IT industry continues to add jobs and strengthen the economy. Additionally, we are remaining competitive in a rapidly evolving global marketplace. While the industry remains strong, we must continually identify ways to mitigate the burdens on these companies in an effort to increase their growth potential, which translates into sustaining and generating high-paying jobs.

Acadian
Ambulance Service

NATIONALLY ACCREDITED

P.O. Box 98000 • Lafayette, LA • 70509-8000

ESOP

EMPLOYEE OWNED

AMBULANCE DISPATCH
911
800-259-1111

ADMINISTRATION
337-291-3333
800-259-3333

BILLING
800-259-2222

July 17, 2013

The Honorable Mary Landrieu
United States Senate
703 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Landrieu:

I hope this correspondence finds you well. I enjoyed visiting with you in our last meeting and hope to have the opportunity to visit with you again soon. I sincerely appreciate the assistance you have provided over the years, the consideration you and your staff have shown Allyson Pharr and Ashel Montes of our Governmental Relations Team and of course your friendship.

As you are aware, Acadian Companies is owned by its 3500+ employees through an employee stock ownership plan, or an ESOP. I always like to say that if my parents taught me anything, it was the value in sharing. It was in honor of this lesson that in 1993 I, along with my Board of Directors, converted Acadian Ambulance Service to an Employee Owned Company, and the rest they say "is history."

We recently learned that Senators Baucus and Hatch have requested that you communicate to them what special tax law provisions you would include in our nation's tax laws if you were drafting a new tax code for the Federal government as if starting from scratch. In light of this, I wanted to take this opportunity to reiterate the importance of not only Acadian's ESOP and the exponential benefits it has bestowed on our employees, our company and the Louisiana and nationwide communities we serve but the importance of ESOPs as a whole.

With regard to Acadian, I sincerely cannot begin to tell you how much Acadian and its employees have benefitted from its ESOP. Over the twenty years that our ESOP has been in place, our employee owners have seen an average growth in our stock price of 12.5%. This, along with the employee's investment in the company they work for has led to an employee retention rate higher than industry average, a lower than industry average in workers' compensation claims and an ability to grow and increase our labor force and the quality and types of services we provide.

The Honorable Mary Landrieu
July 17, 2013
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This internal growth and savings has had a positive economic impact on the communities in which we serve and those in which our employee owners live. An average paramedic who has participated in the ESOP since its inception will have an average account balance of $563,239 to put towards the employee owner's retirement and allow that employee to continue to put money back into their community and our economy and along with other retirement benefits, be self-sustaining.

And we are not alone, as there are pages and pages, and charts after charts, that prove ESOP companies are good for the U.S. economy, are fair by making middle class employees capitalists, and provide excellent retirement benefits.

Among these 35 plus years of research and surveys of ESOP companies and their employees, the General Social Survey of 2010 evidenced that during the Great Recession employee stock owned companies laid off employees at a rate of 2.6% whereas conventionally owned companies laid off employees at a rate of 12.1%.

In sum, promoting ESOP creation and operation is the best jobs policy in the U.S. as the evidence is that the vast majority of ESOP companies are more productive, more profitable, providing locally controlled jobs that through ownership provide better retirement savings benefits than non-ESOP companies.

As you know, I am very passionate about the things that I believe in and this is truly one of them. I therefore respectfully request that you communicate to Senators Baucus and Hatch that you believe our national tax policy should continue to encourage employee stock ownership through ESOPs.

Again, and as always, thank you for your time, consideration and friendship. If I or anyone on our employee ownership team can answer any questions you may have or provide you with additional information, please do not hesitate to ask.

Sincerely,

Richard

Richard E. Zuschlag
Chairman & CEO

df

P.S. If you would like to see additional supporting data, please visit the following website:
http://www.esopassociation.org/explore/employee-ownership-news/resources-for-reporters

COALITION OF SMALL BUSINESS INNOVATORS

July 22, 2013

The Honorable Max Baucus
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Orrin Hatch
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman Baucus and Ranking Member Hatch:

As representatives of small businesses that devote significant assets to innovative research and development (R&D), we support your efforts to reform the tax code, lower the corporate tax rate, and make the U.S. tax system more competitive globally.

The Coalition of Small Business Innovators (CSBI) is a national, non-partisan coalition of organizations dedicated to stimulating sustained, private investment in small companies focusing on the development of transformative, life-changing new technologies. Small business innovation contributes to and benefits from a healthy American economy. We applaud your efforts to lower the corporate tax rate in order to stimulate economic growth and job creation.

CSBI supports your efforts to streamline the tax code in order to facilitate lower rates and international competitiveness. At the same time, Congress also has the opportunity in tax reform to take new steps to inspire innovative R&D. Many research-intensive companies operate without product revenue to fund their scientific progress, so a tax code entirely bereft of research and innovation incentives will not go far enough to support R&D. These pre-tax innovators are helping to lead the search for scientific breakthroughs and revolutionary technologies, and tax reform must encourage their growth. Given that foundational science occurs in the early stages of research and then progresses as a company matures, incentives for pre-revenue innovators will result in growth and stability for the entire innovation ecosystem. As Congress considers tax reform, it should include in that reform targeted provisions that support innovative small companies early in their life cycle.

The Coalition of Small Business Innovators believes that the following sections in the current tax code should be reformed to spur innovation via private investment:

- **Section 469 R&D Partnership Structures.** CSBI supports a limited exception from the passive activity loss (PAL) rules in Section 469 to allow tax assets generated by innovative research to flow through to an R&D project's investors. Relaxing the PAL rules to allow investors to enjoy a more immediate return on their investment would incentivize them to invest at an earlier stage in a company's development.

- **Section 382 Net Operating Loss (NOL) Reform.** CSBI supports exempting NOLs generated by qualifying small business R&D from Section 382's ownership change restrictions. This change would allow small companies the freedom to raise capital for innovative research without fear of losing their valuable NOLs.

- **Section 1202 Capital Gains Reform.** CSBI supports allowing investors in companies with gross assets up to $150 million or with valuable IP to qualify for Section 1202's beneficial capital gains rates. These reforms would allow more growing innovators to attract investors to fund their vital research.

The Coalition of Small Business Innovators believes that Congress can and should incentivize R&D by groundbreaking small companies. Tax reform can improve America's economic health by recognizing the

COALITION OF SMALL BUSINESS INNOVATORS

importance of innovation and its potential to save lives, create new technologies, spur scientific advancement, and create vital jobs in growing businesses. Federal tax policy that recognizes the special demands placed on highly innovative pre-revenue companies will speed the development of products to vastly improve the lives of Americans and people around the world.

We look forward to working with you as Congress undertakes this important effort.

Sincerely,

AdvaMed

Algae Biomass Organization

American Small Manufacturers Coalition

Association of Clinical Research Organizations

Biotechnology Industry Organization

Center for Innovative Technology

Commercial Spaceflight Federation

CONNECT

Electricity Storage Association

Medical Device Manufacturers Association

NanoBusiness Commercialization Association

National Association of State Energy Officials

National Council for Advanced Manufacturing

Neurotechnology Industry Organization

TechAmerica

Water Innovations Alliance

COALITION OF SMALL BUSINESS INNOVATORS

The **Advanced Medical Technology Association (AdvaMed)** is a trade association that leads the effort to advance medical technology in order to achieve healthier lives and healthier economies around the world and acts as the common voice for companies producing medical devices, diagnostic products and health information systems. AdvaMed advocates on a global basis for the highest ethical standards, timely patient access to safe and effective products, and economic policies that reward value creation.

The **Algae Biomass Organization (ABO)** is a non-profit organization whose mission is to promote the development of viable commercial markets for renewable and sustainable commodities derived from algae. Its membership is comprised of people, companies, and organizations across the value chain.

The **American Small Manufacturers Coalition (ASMC)** is a trade association of manufacturing extension agents who work to improve the innovation and productivity of America's manufacturing community. ASMC advocates for legislative and programmatic resources that allow small manufacturers to better compete in the global marketplace. ASMC and its members do this by increasing awareness of the importance of American small manufacturers, the challenges that they face, and the federal legislation and programs that affect them.

The **Association of Clinical Research Organizations (ACRO)** represents the world's leading clinical research organizations (CROs). ACRO members provide specialized services that are integral to the development of drugs, biologics, and medical devices. ACRO advances clinical outsourcing to improve the quality, efficiency, and safety of biomedical research.

The **Biotechnology Industry Organization (BIO)** is the world's largest biotechnology trade association. BIO provides advocacy, business development, and communications services for more than 1,100 members worldwide. BIO's mission is to be the champion of biotechnology and the advocate for its member organizations – both large and small.

The **Center for Innovative Technology (CIT)** creates technology-based economic development strategies to accelerate innovation, imagination, and the next generation of technology and technology companies. Created in 1985, CIT, a non-profit corporation, plugs gaps at the earliest stages of the Innovation Continuum – commercialization and seed funding – as it helps entrepreneurs launch and grow high-growth technology companies and create high-paying jobs for the future. To facilitate national innovation leadership and accelerate the rate of technology adoption, CIT creates partnerships between innovative technology start-up companies and advanced technology consumers. Lastly, CIT builds the infrastructure for new innovation economies with expert broadband strategies.

The **Commercial Spaceflight Federation (CSF)** is the industry association of leading businesses and organizations working to make commercial human spaceflight a reality. The mission of the Commercial Spaceflight Federation is to promote the development of commercial human spaceflight, pursue ever higher levels of safety, and share best practices and expertise throughout the industry.

CONNECT is a program that catalyzes the creation of innovative technology and life sciences products by linking inventors and entrepreneurs with the resources they need for success. Since 1985, CONNECT has assisted in the formation and development of more than 3,000 companies. CONNECT focuses its efforts on accelerating the commercialization of new technology and life sciences products.

The **Electricity Storage Association (ESA)** is the world's premier energy storage trade organization. ESA's members include utilities, technology developers and manufacturers, national laboratories, system designers, and academia using the ESA as the leading forum to promote a better understanding of the benefits of storage in the electricity grid. Long considered the leading technical resource on storage related issues, ESA members actively engage in numerous activities to promote the development and commercialization of competitive and reliable energy storage systems.

The **Medical Device Manufacturers Association (MDMA)** is a national trade association providing educational and advocacy assistance to innovative and entrepreneurial medical technology companies. Since 1992, MDMA has been the voice for smaller companies, playing a proactive role in helping to

COALITION OF SMALL BUSINESS INNOVATORS

shape policies that impact the medical device innovator. This is accomplished by maintaining relationships with key Members of Congress, senior staff at FDA and CMS, and through the grassroots support of MDMA members.

The **NanoBusiness Commercialization Association (NanoBCA)** is a trade organization dedicated to promoting the commercialization of nanotechnology and helping companies bring affordable, life-improving nanotech products to the market.

The **National Association of State Energy Officials (NASEO)** is the only national non-profit association for the governor-designated energy officials from each state and territory. Formed by the states in 1986, NASEO facilitates peer learning among state energy officials, serves as a resource for and about state energy offices, and advocates the interests of the state energy offices to Congress and federal agencies.

The **National Council for Advanced Manufacturing (NACFAM)** is an industry-led policy research organization, working collaboratively with industry, education, government, and trade/professional associations since 1989 to accelerate the development of advanced technologies and related workforce skills.

The **Neurotechnology Industry Organization (NIO)** is the first and only trade group that lobbies on behalf of neuroscience-focused companies, brain research institutes, and patient advocacy groups across the spectrum of neurological disease, psychiatric illnesses, and nervous system injuries.

TechAmerica is the leading voice for the Information and Communications Technology (ICT) industry in the United States. TechAmerica's membership is comprised of large, medium, and small technology companies that create a variety of products and deliver a multitude of services in the private sector and to governments at the state and national level. TechAmerica's top priority is to foster an environment for their members to succeed through comprehensive global, national, and regional advocacy, and high-level business intelligence that delivers an edge in the marketplace.

The **Water Innovations Alliance (WIA)** is the public policy voice of the world's water researchers, technologists, and innovators. The Alliance's role is to advocate policies that promote the aggressive development of water technologies and innovations across all sectors and users of water by creating new market opportunities, increasing funding, strengthening research and development programs, removing regulatory and market barriers, and improving education, communication, and outreach efforts.

CUNA
Credit Union National Association
cuna.org
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July 16, 2013

The Honorable Mary Landrieu
United States Senate
703 Hart Senate Office Building
Washington, DC 20510

Dear Senator Landrieu:

On behalf of the Credit Union National Association (CUNA) and the 96 million members of America's credit unions, I am writing to urge you to include the retention of the credit union tax status among your priorities in the Senate Finance Committee's tax reform process. CUNA is the largest credit union advocacy organization in the United States, representing America's state and federally chartered credit unions and their members.

We believe that Congress should retain the current tax treatment of credit unions because the credit union tax status continues to serve the purpose for which it was created. It is good public policy because it causes the creation of substantial benefits to the public, far in excess of its cost. Finally, taxing credit unions would represent a tax increase on 96 million Americans and would likely lead to the elimination of many, if not most, credit unions.

Congress conveyed an exemption from federal income tax to state and federally chartered credit unions because of their ownership structure and special mission. Credit unions are member-owned, democratically governed, not-for-profit cooperative financial institutions generally managed by volunteer boards of directors, with a specified mission of promoting thrift and providing access to credit for provident purposes to their members, especially those of modest means.[386] Through the enactment of the Federal Credit Union Act and the credit union tax exemption, as well as enabling legislation in all 50 states, Congress and the states have sanctioned and encouraged the development of a dual-charter credit union system that is an alternative to the for-profit banking sector, comprised of financial institutions controlled by members and accessible to all.

As you know, credit unions were established at the Federal level during the Great Depression, but existed in many states as far back as 1908; their inception was driven by a demand for access to basic financial services – loans and savings. Credit unions

[386] 14 USC 12 § 1751.

have been exempt from Federal taxation since the earliest days of the tax code.[387] Credit unions' exemption from Federal income tax has been conveyed in order to support and sustain a system of cooperative financial services in the United States. The existence of this thriving set of alternative financial institutions benefits not only the members of credit unions, but also customers of for-profit banks and other institutions.

As the years have passed, the financial services sector has developed, and the entities providing financial services, including credit unions, have evolved. Some have suggested that with the evolution of expanded services offered by credit unions, they have become simply untaxed banks. That position ignores the very real differences that distinguish investor-owned and cooperative firms. The fact of the matter is that even though credit union services have evolved, their structure and mission have remained the same.

Precisely because of their cooperative structure, credit unions behave differently from investor-owned financial institutions, and that difference in behavior produces substantial benefits both to the nation's 96 million credit union members, and also to non-members and the economy as a whole.

Two features of the cooperative structure are crucial in generating substantial benefits to society: their total focus on member value and service, and their tendency to risk aversion. Because of credit unions' strong member focus, driven by their democratic governance structure, credit unions have every incentive to not only "pass on" but also to leverage the benefits of the tax exemption rather than diverting it in some form of expense preference.[388] The cooperative structure also discourages excessive risk taking by credit unions. Because they take on less risk, they tend to be less affected by the business cycle, and therefore can serve as an important counter cyclical economic force in local markets, softening the blow of economic downturns in local

[387] Credit unions were first made tax exempt in 1917 through a ruling by the United States Attorney General. The ruling noted that, "On examination of the purpose and object of such association, it appears that they are substantively identical with domestic building and loan associations or cooperative banks 'organized and operated for mutual purpose and without profit' [quoting from the 1916 statute]. It is to be presumed that the Congress intended that the general terms used in Section 11 should be construed as not to lead to injustice, oppression, or an absurd consequence." This served as the basis for the exemption of state chartered credit unions from federal income tax until 1951, when mutual savings banks lost their tax exemption because they were deemed to have lost their mutuality but credit unions retained their tax exemption because, as is the case today, they hold firm to their mutuality and cooperative principles. Federally chartered credit unions were made exempt from federal income tax in 1937.

[388] *Expense preference* refers to managerial behavior that places the preferences of managers (inflated salaries and benefits, perquisites, lavish offices, etc.) ahead of the otherwise recognized goals of the firm. In an investor owned firm, expense preference behavior would result in sacrificing profit (investor value) for managerial preferences. For tax-exempt credit unions, expense preference behavior would imply providing excessive managerial emoluments rather than using or leveraging the tax exemption for the benefit of members. There is NO evidence of expense preference resulting from the tax exemption: Comparing similarly sized banks and credit unions, both have expense-to-asset ratios in the range of 3 to 3.5%; the aggregate 10.4% credit union capital ratio is over four percentage points higher than the level regulators consider to be "adequate" but is no higher than the aggregate bank equity capital ratio; also, as noted elsewhere in this letter, compensation comparisons between banks and credit unions show lower compensation for credit union senior executives at similar sized institutions – and substantially lower compensation when data on bank stock options, grants and similar non-cash compensation is considered.

economies. In addition, credit unions' member focus and the absence of a strong profit motive allow them to offer significant advantages to their members of modest means.

As a consequence of their member-focused, cooperative structure, credit unions confer on their members and the rest of society benefits that far exceed the amount of revenue lost to the Treasury due to the tax exemption. The Joint Committee on Taxation's most recent estimate of the credit union "tax expenditure" is $0.5 billion in both 2012 and 2013, and an average annual cost of $0.8 billion over the five years from 2013 through 2017. The benefits that credit unions provide to both members and others far exceed those totals, amounting to an estimated $8 billion in just 2012. The tax exemption is leveraged because credit unions do not pay dividends to stockholders, generally do not compensate their directors, and do not compensate senior executives as highly as banks do when stock options and grants are taken into consideration.

Credit unions provide benefits directly to their members in the form of lower fees, lower rates on loans, and higher yields on deposits than those available at other financial institutions. Applying rate differentials from a third party source (Datatrac) to the volumes of various loan and deposit accounts at credit unions, and applying fee differentials to credit union non-interest income, allow us to calculate the total amount that members benefit from using credit unions. In 2012, we calculate the total of member benefits to have been almost $6 billion. In addition, several independent researchers have found that credit unions have a moderating influence on bank pricing: raising bank deposit interest rates and lowering bank loan rates.[389] Based on this research, we estimate that bank customers saved about $2 billion in 2012 from more favorable pricing due to the presence of credit unions in their local markets.

Compared to historical measures of these consumer benefits, the total of $8 billion in 2012 was relatively subdued because of the unusually low level of most interest rates during the year. When all interest rates are compressed near zero, there is less room for typical differences between credit union and other rates. Prior to the financial crisis, the combined member and non-member benefits totaled more than $12 billion annually, and these levels are likely to be achieved again in the future once interest rates rise.

In addition to these quantifiable benefits, credit unions also provide consumers of financial services significant intangible benefits. As member-owned and governed institutions, credit unions focus on providing exceptional member (customer) service. This too places competitive pressure on banks to follow suit. In the 21 years from 1985 to 2005, the *American Banker* newspaper published an annual survey of consumers of financial services, and each year credit unions scored much higher than

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[389] Robert J Tokle, *The Influence of Credit Unions on Bank CD Rate Payments in the US,* New York Economic Review, Fall 2005. Timothy H. Hannan, *The Influence of Credit Unions on the Rates Offered for Retail Deposits by Banks and Thrift Institutions,* Federal Reserve Board of Governors, September 2002. Robert M. Feinberg, *The Competitive Role of Credit Unions in Small Local Financial Services Markets,* Review of Economics and Statistics, August 2001. Robert M. Feinberg, *The Effects of Credit Unions on Bank Rates in Local Consumer Lending Markets,* Filene Research Institute, 2001.

banks in customer service. We are aware of sessions at bank conferences with titles such as "Emulating the Customer Service of Credit Unions." This is just another way that the existence of a cooperative alternative to investor-owned banks has value not only to credit union members but also to bank customers.

The incentives faced by credit union management (generally uncompensated volunteer boards, the absence of stock options for senior management and board members, the absence of pressure from stockholders to maximize profits) induce management to eschew higher-risk, higher-return strategies.[390] As a result, credit union operations are less risky, and subject to less volatility over the business cycle. For example, from 1992 to 2012, the average annual net charge-off rate on credit union loans was 0.61%, with a standard deviation of 0.22%. In contrast, the similarly computed average at banks over the same period was 0.99%, with a much greater standard deviation of 0.62%.

Because of this lower-risk profile, credit unions were able to continue lending during the recent financial crisis while other financial institutions failed or had to curtail operations due to damaged balance sheets caused by riskier practices leading up to the crisis. As the secondary market for residential mortgages collapsed in 2007, the amount of first mortgages originated by credit unions actually rose by 11% in 2007 and 18% in 2008. From June 2007, the onset of the financial crisis, to December 2012, small business loans outstanding at credit unions grew by 65.8% while such loans at banks actually declined by 13.5%. A study recently published by the Small Business Administration found, "that credit unions are increasingly important sources of small business loans as a longer-run development and in response to fluctuations in small business loans at banks."[391] The tax exemption, by fostering the continued existence of credit unions as a cooperative alternative in the market, supports this countercyclical lending role for credit unions.

Credit unions offer full and fair service to all of their members, and credit union membership tends to be concentrated in the working class of Americans. Over half of credit union members who rely primarily on their credit union for financial services have incomes between \$25,000 and \$75,000. Credit unions also do not shy away from serving their members where they are most needed. Nationwide, fully 42% of credit union branches are located in CDFI investment areas, compared to only 32% of bank branches in such areas.

Compared to other providers, credit unions offer services to lower-income members at prices that are very attractive, and with less of a price differential to services offered to higher income members. In fact, credit unions sometimes charge their lower-income members less for a service than banks charge even their higher-income customers. For example, a recent study found that the fees banks collect on an annual

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[390] Edward J. Kane and Robert J. Hendershott, *The Federal Deposit Insurance Fund that Didn't Put a Bite on U.S. Taxpayers*, Journal of Banking and Finance, 20 (September, 1996), pp. 1305-1327. Kane and Hendershott describe how the cooperative structure of credit unions presents credit union decision makers with incentives that are strikingly different from those faced by a for-profit financial institution, making it less feasible for credit union managers to benefit from high-risk strategies.

[391] James A. Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending,* Office of Advocacy, Small Business Administration, September 2011. p v.

basis on low balance checking accounts ($218) are two and a half times what they collect on their high-balance accounts ($90).[392] In contrast, fees credit unions collect on low- balance accounts ($80) are less than a third of those collected by banks on low-balance accounts, are even less than what banks collect on high-balance accounts, and are less than twice what they collect on their own high-balance accounts ($42). In other words, consumers generally get better deals from credit unions than from banks, and this is particularly true for lower income members.

In addition to providing access to financial services, credit unions also endeavor to provide financial literacy education to their members, and to encourage individual and family level thrift and saving. Sixty nine percent of credit union members belong to a credit union that offers some form of financial education. Fifty seven percent of credit unions members belong to a credit union that offers financial literacy workshops. Twenty percent of credit union members belong to a credit union that operates one or more in-school branches. Credit unions engage in this activity not just through altruism, but also because it is in the best interest of the credit union to have members who are educated on how to best use the cooperative.

Tax policy has consistently recognized that the health of small, locally controlled businesses is vital to the country's economic health. The credit union tax exemption furthers this goal in a manner similar to the tax treatment of Subchapter S corporations, investor-owned firms with no more than 100 shareholders. There are now more than 2,200 Subchapter S banking institutions in the US which jointly account for $510 billion in assets. While bank Subchapter S election is not the same as a tax exemption, it does significantly reduce Treasury revenue by between a quarter and a third compared to what those banks would pay as normal Subchapter C corporations. The lost revenue due to bank Subchapter S election is estimated to be $0.8 billion in 2012.

The importance of having not-for-profit credit unions as vibrant and viable alternatives in the financial services marketplace is as significant today as it has ever been, and the credit union tax exemption is crucial to encourage and support the continued existence of this alternative, cooperative component of the financial system. In the aftermath of the financial crisis, more Americans are choosing credit unions as their best financial partner. In fact, in 2012, more than 2 million Americans joined credit unions. Some may have joined because their bank failed, moved or was acquired by another institution; and others may have joined because they grew frustrated with the policies and fees of the for-profit sector. As credit union members, they benefit from conducting their financial services with an institution that they own; this means when the credit union succeeds, credit union members succeed.

Through these and other activities, credit unions employ the tax status to fulfill the purpose for which it was created. As a result, the credit union tax status has proved not only to be good public policy but also to represent an incredible return on the investment that the government has made. Credit unions provide accessible and

[392] Victor Stango and Jonathan Zinman, *What People Pay: Deposit Account Fees at Banks and Credit Unions,* Filene Research Institute, November 2009. The authors, from the University of California, Davis and Dartmouth College analyzed the results of actual account usage at banks and credit unions. The annual fee totals are the result of the volume of various types of transactions, and the pricing of those transactions.

affordable basic financial services to people of all means and encourage the equitable distribution of capital across all individuals, families, communities, and small businesses. Credit unions infuse financial market competition with multiple and differentiated competitive business models. They help keep financial services accessible – and affordable – for all consumers, whether they are members of a credit union or not.

Some in the for-profit financial services sector would like to see Congress repeal the credit union tax exemption. Doing so, however, would undoubtedly result in negative consequences for savers and borrowers, the most severe of which would be the erosion of a credit union option for millions of Americans. If taxed, a very significant number of larger credit unions are expected to convert to banks to take advantage of the much greater flexibility of a bank charter, and an equally significant number of smaller credit unions would simply liquidate. The remaining credit unions would have to pass the burden of taxation through to their members because they are wholly-owned cooperatives, increasing the cost of accessing mainstream financial services.

Taxing credit unions would undermine the purpose for which credit unions were created, and amount to a gift of tens of millions of customers to the for-profit banking industry at a time when the public is exceptionally dissatisfied with that industry and is actively pursuing alternatives. Furthermore, taxing credit unions would do very little in terms of addressing the federal budget deficit. Taxing credit unions would only account for 0.06% of this year's deficit; it would take 1,600 other such sources of a similar size to eliminate the deficit. It would fund the federal government for barely more than one hour. But, it would represent a tax increase on the 96 million members of credit unions.

One of the motivations behind comprehensive tax reform is to reduce distortions of resource allocation caused by preferences and exemptions, thereby allowing a reduction in corporate tax rates by expanding the tax base. The resource reallocation occasioned by the credit union tax exemption has been modest – for the past two decades credit unions have accounted for only 6% of the assets in US depository institutions. Nevertheless, as I described above, more than 96 million working-class Americans benefit in an amount much greater than the cost of the tax exemption. Applying corporate tax rates to credit unions would raise less than 0.5% of corporate tax revenue, allowing almost no reduction in corporate tax rates – however, once again, it would represent a tax increase on 96 million Americans.

On behalf of America's credit unions and their 96 million members, thank you very much for your consideration of our views. We encourage you to retain and reaffirm the credit union tax status.

Best regards,

Bill Cheney
President & CEO

LouisianaBankers
ASSOCIATION

July 17, 2013

Senator Mary 431
Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Landrieu,

On behalf of Louisiana's tax paying banking industry, I request that you support and promote the taxation of the tax exempt credit union industry. The Senate Finance Committee leadership has begun the process for tax reform, seeking input from their colleagues and others on ways to create a tax code that is free of special-interest provisions in the form of exclusions, deductions, credits, and other preferences – special breaks often referred to as "tax expenditures" because they come at a cost to American taxpayers. Chairman Max Baucus (D-MT) and Ranking Member Orrin Hatch (R-UT) noted that such tax breaks should only be retained if they (1) help grow the economy, (2) make the tax code fairer, or (3) effectively promote other important policy objectives. Based upon the evidence, the credit union tax exemption does not meet these policy objectives and can no longer be justified. One point that may escape some is that Louisiana has a number of tax paying mutually owned thrifts, all members of the Louisiana Bankers Association, whereby there are no shareholders, just as credit unions are structured. The federal tax exemption for these mutually chartered institutions was repealed decades ago. It is past time for credit unions to pay their way.

The Credit Union Tax Exemption Does Not Help the Economy Grow

A loan to a creditworthy borrower made by a credit union is a loan that any bank would be happy to make. The credit union tax exemption merely shifts the same business to tax-favored credit unions without adding to economic growth. In fact, this shift distorts market forces, lowering productivity and harming economic growth. As economic activity moves from the taxable sector of the economy to the tax-exempt sector, it will add to the federal deficit and reduce long-term economic growth.

The Credit Union Tax Exemption Does Not Make the Tax Code Fairer

Large, fast-growing, and increasingly complex credit unions have diversified to the point that they bear no resemblance to the traditional credit unions that Congress envisioned to be worthy of preferred tax status. Credit unions compete head-to-head with Louisiana community banks, with the added advantage of being tax-exempt. The tax system should not provide a competitive advantage for particular commercial enterprises. Credit unions should be taxed on the same basis as other financial institutions. Other cooperatively owned financial institutions pay taxes. Congress eliminated the tax exemption for mutual insurance companies in 1942 and for mutual savings banks in 1951. More than 200 credit unions have assets over $1 billion, making each of them larger than 90 percent of taxpaying banks.

These large credit unions are only 3 percent of the entire credit union industry, yet they account for 62 percent of the credit union tax expenditure. A U.S. family of four pays *more* Federal income taxes than the *entire $1 Trillion Credit Union Industry.*

The Credit Union Tax Expenditure Is Being Abused and No Longer Serves An Important Policy Objective

The credit union tax exemption was originally intended as a way to subsidize financial services for individuals with low or moderate income. But a 2006 GAO study found that 14 percent of credit union customers were of low-income and 17 percent were of moderate-income, while 49 percent were of upper-income. Credit unions serve a wealthier and more educated customer base than taxable banks. The credit union tax exemption subsidizes financial services to those who clearly do not need it. Moreover, credit unions have never had to document that this tax subsidy was actually used as intended, and there is no examination by credit union supervisors to assure compliance. If the tax exemption is no longer conditioned upon the goal of serving low- and moderate-income individuals, it can no longer be justified and should be repealed.

The Credit Union Tax-Exemption Should Be Repealed

The credit union tax exemption is a Depression-era tax break that has outlived its purpose. It no longer supports the public policy of providing financial services to low- and moderate-income consumers. Previous administrations – both Democratic and Republican – have recommended ending the credit union industry's tax exemption. The time has come for Congress to abolish this exemption. It would be a fiscally sound way to help reduce the U.S. debt and eliminate distortions in the financial services industry.

Thank you for considering this request.

Sincerely,

Robert L Taylor

Robert Taylor
Chief Executive Officer
Louisiana Bankers Association

Louisiana
Credit Union League

July 12, 2013

The Honorable Mary Landrieu
724 Hart Senate Office Building
Washington, DC 20510

Dear Senator Landrieu:

As Congress turns its attention to comprehensive tax reform, we urge you to do what's in the best interest of our state's nearly 1.2 million credit union members and the countless others that benefit from the small businesses across the state supported by Louisiana credit unions, and help maintain the current credit union tax exempt status.

As not-for-profit financial cooperatives, credit unions continue to fulfill the mission Congress gave them to promote thrift and provide access to credit for provident purposes. Because of credit unions' member-focused, cooperative structure, the benefit consumers and small businesses receive as a result of the credit union tax exemption far exceeds the cost to the government of providing the exemption. The Joint Committee on Taxation's most recent estimate of the credit union "tax expenditure" is $0.5 billion in both 2012 and 2013. The benefits that credit unions provide to both members and others far exceed those totals, amounting to an estimated $8 billion in just 2012.

Credit unions provide benefits directly to their members in the form of lower fees, lower rates on loans, and higher yields on deposits than those available at other financial institutions. As Chair of the Senate Committee on Small Business and Entrepreneurship, you understand the importance of providing small businesses access to the tools they need for success, and credit unions across Louisiana are doing just that through business lending programs and a variety of other services.

Eliminating the credit union tax exemption would represent a tax increase on America's 96 million credit union members. The Credit Union National Association (CUNA) estimates that Louisiana credit unions provided $54 billion in direct financial benefits to the state's members during the twelve months ending in March 2013. These benefits are equivalent to $46 per member. At a time when many of our states residents are struggling to make ends meet, we cannot do something that would reduce the amount of money in their pockets each month and would also hurt small business owners.

As the July 26 deadline approaches to send your priorities for tax reform to the Finance Committee, we urge you to include the retention of the credit union tax exemption among your priorities in the tax reform process.

Sincerely,

Anne M Cochran

Anne Cochran, President/CEO

AC/jg

cc: Bill Cheney, CUNA & Affiliates
Jeffrey Brooks, Adams & Reese

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professional beauty association

Statement for the Record

Senate Small Business Committee Roundtable:
Small Business Tax Reform: Making the Tax Code Work for Entrepreneurs and Startups

July 17, 2013

As the Senate Small Business Committee considers important issues related to tax reform, the Professional Beauty Association (PBA), on behalf of salon owners, manufacturers and distributors in the industry, appreciates the opportunity to work with you on legislation to equalize the tax treatment of tipped industries, while improving compliance.

Background
Prior to 1988, employers were required to pay FICA taxes only on tips used to meet minimum wage obligations. (Many states allow employers to pay tipped employees a cash wage that is below the minimum wage and apply tip earnings toward the balance of the minimum wage; this is known as the "tip credit.") However, beginning in 1988, Congress required employers to pay the employer FICA tax on <u>all</u> tips, rather than just on tips used to meet minimum wage obligations. Congress reasoned that, since employees earned a substantial portion of their income from tips, that income should be accounted for in the employee's Social Security wage histories and related withholdings.

In 1993, Congress granted the restaurant industry a dollar-for-dollar tax credit – now known as the 45(B) tax credit – on the employer's share of FICA taxes paid on tip income above the minimum wage. This policy was instituted because Congress recognized that tips are a gratuity paid to wait staff by the customer, and employers should not be responsible for paying FICA taxes on income that was not paid by them. Employers in the salon industry are not currently eligible to receive the 45(B) tax credit, even though their employees, like the restaurant industry, earn a large portion of their income through tips received directly by employees – not by the salon.

By including the **bipartisan** Small Business Tax Equalization and Compliance Act (S. 974 in the 112th Congress) language in tax reform, **Senators can help grow this part of the economy, make the tax code fairer and effectively promote other important policy objectives such as improved reporting and compliance:**

- **Support a vital and growing sector of America's Economy**. Job growth in the salon industry has outpaced the overall economy in eight of the past nine years. This industry is home to a large number of entry-level jobs in which employees have a significant potential for training and upward mobility. The vast majority of managers and salaried employees in salons started out in entry-level positions. Additionally, the salon industry is one of America's most diverse industries. According to the Bureau of Labor Statistics, the salon industry employs a higher proportion of African-Americans, Asians and women than the overall U.S. workforce. Even so, this industry is not immune to the current economic crisis. **Extending the 45(B) tax credit to salons will help this vibrant and important sector.**

- **Improve Tip Reporting.** In recent years, there has been a significant shift from traditional employment-based salons, where cosmetologists function as regular payroll employees (with benefits such as paid vacation time and retirement savings plans) to non-employer salons, where cosmetologists simply rent a booth from a salon owner and function as a self-employed, independent contractor. While employer-based salons are required to collect tip information from their employees, independent contractors are responsible for reporting their own tips. Although non-employer salons compromise 87 percent of establishments, their reported sales represent only 36 percent of total salon industry revenues, implying a significant underreporting of income in the non-employer segment. **This legislation includes education and reporting requirements which may reveal a valuable new source of tax revenues for the federal government.**

- **Promote Tax Fairness:** Tips to restaurant workers should not be treated differently from tips to salon workers. These industries share tip reporting burdens, but do not share the relief granted to the restaurant industry 15 years ago.

- **Help Small Businesses.** Small businesses are the backbone of America's economy and the salon industry is an industry of small businesses. According to the U.S. Census Bureau, 98 percent of salon industry firms have only one establishment; 92 percent of salon establishments have sales of less than $500,000; and 82 percent of salon establishments have fewer than 10 employees. **Extending the 45(B) tax credit to salon owners would allow them to reinvest in their businesses and employees, granting new economic and employment opportunities in their local communities. Additionally, the salon industry is vitally important to the success of many other industries in the economy. Every dollar spent in the salon industry generates an additional $1.77 of sales for other industries in the economy, according to the U.S. Department of Commerce.**

PBA appreciates Senator Landrieu's leadership on this issue and the Small Business Committee's consideration. We would welcome the opportunity to continue to work with the Committee members and staff and hope that you will use us as a resource.

SMALL BUSINESS
INVESTOR ALLIANCE

July 17, 2013

The Honorable Mary Landrieu
Chairwoman, Senate Small Business
and Entrepreneurship Committee
428-A Russell Senate Office Bldg.
Washington, D.C. 20510

The Honorable Jim Risch
Ranking Member, Senate Small
Business & Entrepreneurship Cmte.
428-A Russell Senate Office Bldg.
Washington, D.C. 20510

Dear Chairwoman Landrieu and Ranking Member Risch,

On behalf of the Small Business Investor Alliance (SBIA), the premier organization of lower middle market private equity funds and investors, thank you for focusing on ways to spur entrepreneurship and small business job creation through smart tax policy. Our current tax system is incomprehensibly complicated, so much so that it severely hindering our nation's ability to be economically robust and prosperous.

The SBIA believes the most important goal for tax reform should be to encourage real, market-driven investments in job-creating small businesses. Small businesses employ half of the workforce and small firms accounted for 67 percent of the net new jobs since the latest recession, from mid-2009 to 2011,[1] and the best way to generate the most jobs is to promote smart tax policy that supports investment in small businesses.

Small business investors make investments in the form of debt and equity financing. Without this growth capital, small businesses would be starved of needed capital to finance their most productive assets such as their employees, land, inventory, and equipment. Private equity funds serve a critical role in growing small businesses and working with them to put these assets to work more productively. Like the nation, our private equity funds can only prosper when small business prospers.

Small businesses that are backed by private equity have an undeniable impact on job creation and revenue growth. According to a 2012 Pepperdine University study, over a five year period after a financing event, private equity backed establishments generated 129 percent more revenue growth and 257 percent more employment growth than their non-private equity backed

[1] Bureau of Labor Statistics: www.bls.gov/bdm

counterparts.[2] This economy desperately needs more robust job growth. This economy needs more private equity investment.

As the committee examines how the tax code can be changed to improve the fiscal environment for entrepreneurs, we encourage you to carefully analyze the impact of taxes on the cost of capital for small firms. Higher taxes have a disproportionately negative impact on a small company's ability to grow. This negative impact is doubled when taxes are increased on small business investment funds because taxes raise the cost of capital they must charge small businesses. That is why we urge the Committee to focus on lowering the cost of capital for entrepreneurs because this will improve their ability to purchase as many productive assets as possible, which increases their chances for success.

There are several opportunities on the table to keep the cost of capital low for small businesses. Clearly keeping taxes low on capital gains, dividends, and interest would benefit all investing. We also strongly encourage Congressional tax writers to focus on small business investing by: 1) modernizing and making permanent the exclusion on gain from investments in small businesses; 2) restoring the debt interest expense deduction for smaller companies; 3) preventing changes in the tax treatment of carried interest for small private equity funds; and 4) encouraging tax-exempt entities to invest in private equity.

Qualified Small Business Investment

Thanks to the work by Chairwoman Landrieu to prioritize this issue as an end of the year tax extenders bill, the qualified small business (Section 1202 of the U.S. Tax Code) was extended by Congress to allow for a temporary 100% exclusion from gross income of gain derived from qualified small business stock held for more than five years. This is an important provision.

SBIA recommends making certain updates to the provision to allow for its continued and expanded use. Modernizing the qualified small business provision to reflect current business structures will encourage short- and long-term investments in businesses that depend on early-stage and growth capital to excel.

The current definition of "qualified small business" under the 1202 provision is based on an active business test and an aggregate gross assets (under $50 million) test. Additionally, the definition only applies to C-corporation (excluding LLCs and other common small business structures) stock investments held for more than five years. There are also industry limitations (hotels, oil and gas, and other businesses are not eligible) and confusing limitations on the amount of portfolio stock and real estate that an eligible corporation can hold. Taken together, these limitations make it more difficult for the investor to identify eligible investments.

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[2] Paglia, John and Maretno Harjoto. "Did They Build That? The Role of Private Equity and Venture Capital in Small and Medium Sized Businesses." Graziado School of Business and Management, Pepperdine University, http://bschool.pepperdine.edu/newsroom/wp-content/uploads/2012/12/Paglia-Harjoto-PE-VC-11.29.2012-IEGC.pdf

Making the exclusion permanent would increase investment in small businesses because currently the provision lapses at the end of 2013, and this may have an impact on future investment. President Obama's 2014 Budget Request recommends making the 100% exclusion provision permanent and reducing the holding period for certain taxpayers that rollover their gain into new qualified small business stock.[3] This provision adds a new six month rollover period for taxpayers that reinvest the proceeds from sales of qualified small business stock held longer than three years.

We also recommend the committee provide a partial exclusion of gain on qualified small business stock held for more than three years but less than five years. For example, a tiered schedule that provides a 60% exclusion for taxpayers that hold qualified small business stock between three to four years and a 80% exclusion for stock held between four to five years would help expand investments in small businesses.

The treatment of a percentage of excluded gain as a preference under the AMT eliminates almost all the benefit of the provision for investments made before February 18, 2009. By not repealing the AMT preference for all excluded gain on qualified small business stock, the exclusion would be limited for some taxpayers. President Obama's 2014 Budget Request recommends repealing this provision.[4]

The current gross assets qualification of $50 million needs to be increased to keep up with the growth of the economy. Increasing this amount would have a very positive impact on certain industries with expensive capital assets such as manufacturing. SBIA recommends adjusting this threshold for inflation or increasing the gross assets qualification to $75 million.

Current law limits qualified small businesses to C Corporations. The types of business entities that are eligible "qualified small businesses" should be expanded to include S corps and LLCs which are also important business entities in our economy. It does not make sense to penalize entrepreneurs for using the most commonly used small business structures.

Small Business Investment Companies (SBICs), created by the Small Business Investment Act of 1958, have a long history of financing small businesses to expand and create jobs. Despite the fact that SBICs must invest exclusively in domestic small businesses, some of the industries that SBICs invest in are ineligible for the 1202 exclusion. These excluded industries are becoming more prominent with the growth of the services industry in the U.S. economy. SBIC investments should qualify under 1202. At a minimum, the active financing test should be expanded to include industries that are more prominent in this 21st century economy.

Many small business investors often purchase warrants which are debt instruments with the option to acquire a stock at a certain price in the future. These types of products would not be

[3] http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals. Page 25
[4] Administration's Fiscal Year 2014 Revenue Proposal, page 25.

eligible for the 100% exclusion unless the taxpayer acquires and holds the stock for longer than five years. Many small business investors do not exercise their rights to purchase the stock until years after the original transaction of the warrant, and therefore may not hold the acquired stock for more than five years. The law should be changed to allow for partial exclusion of gain for taxpayers that hold debt converted into stock.

Interest on Debt Deductibility

Debt is a fundamental part of a typical company's capital structure and is often used to finance small business activities like meeting payroll, buying raw materials, making capital expenditures, and acquiring new business ventures. We encourage Congress to maintain interest on debt as an ordinary business expense because businesses rely on debt to finance their operations and grow. Removing the deductibility of interest for small business owners and investors would be catastrophic, causing good businesses to fail and countless jobs to be lost.

Small firms looking to finance their activities with debt undergo rigorous due diligence from their creditors, and this due diligence pays off because it is a process that weeds out bad investments and helps ensure against default. Small business investors invest long-term patient capital to provide the best opportunity and flexibility for the company to grow and create jobs.

The tax code treats interest on debt as an ordinary business expense that is fully deductible from a company's taxable income. Interest is incurred in the ordinary course of a trade or business, and it should continue to be treated the same as any other ordinary business expense for tax purposes. It is also worth noting that allowing the deduction of interest aligns the tax code with generally accepted accounting principles (GAAP) accounting.

Placing limits on the deductibility of business interest would harm investments in domestic small businesses and would increase the cost of capital to finance business activities. Limiting the deductibility of interest would penalize the growth of smaller or more dynamic companies that are reliant upon external financing to manage cash flow, innovate, expand and create jobs.

Carried Interest

Tax policy should encourage the pooling of capital in a manner that promotes entrepreneurship and growth. Pooling capital increases the amount of capital available for small businesses investment. The Committee should be mindful of the disproportionate impact changing carried interest rules will have on smaller private equity funds. The smaller the fund, the less it will be able to withstand an increase in the tax rate for carried interest because smaller funds cannot survive solely on asset-based management fees. For smaller funds, asset-based management fees are too small to maintain top fund managers so they depend upon the performance-based business model to retain top small business investors for the 10+ years of the fund lifecycle. For smaller funds, if the carried interest tax rate increases dramatically, it becomes difficult to sustain a fund. Therefore, the only way for a small fund to survive will be to become a very large fund that can survive on asset-based management fees – fees which are completely disconnected from performance.

Unrelated Business Taxable Income (UBTI)
A significant source of capital for private equity funds comes from tax-exempt entities such as pension funds, foundations, and other tax-exempt investors. Generally, a tax-exempt organization is exempt from federal taxes on its passive investment income. However, tax-exempt entities are required to file tax returns and pay income tax on "unrelated business taxable income" (UBTI), which occurs when a tax-exempt entity incurs debt in connect with an acquisition of income property not related to the exempt organizations purpose. The tax code and IRS regulations allow tax-exempt investors to limit UBTI in certain cases when investing in private equity partnerships. These solutions need to be kept in mind because removing them in tax reform could ultimately reduce or eliminate a significant source of capital for private equity funds. As a result of reducing the tax-exempt source of investment capital, the cost of growth capital would increase dramatically for entrepreneurs.

We appreciate your focus on the impact of tax policy on small businesses, and look forward to working with you to encourage smart tax policy that prioritizes job creation and small business investment.

Sincerely,

Brett Palmer
President
Small Business Investor Alliance

cc: Members of the Senate Small Business and Entrepreneurship Committee