



**Testimony on Federal Small Business Tax Policy
Before House Taxation Committee**

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On behalf of the National Federation of Independent Business (NFIB), thank you for the opportunity to submit testimony providing an update about federal tax policy, specifically as it relates to small businesses. NFIB is the nation's leading small business advocacy association, representing members in Washington, D.C., and all 50 state capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses. NFIB represents about 325,000 independent business owners who are located throughout the United States, including over 4,200 members in Kansas.

The typical NFIB member employs about eight to ten employees with annual gross receipts of about \$500,000. All of NFIB's Members are independently owned, which is to say that none are publicly traded corporations. While there is no one definition of a small business, the problems our members confront relative to the tax code are representative of most small businesses.

There were a number of important tax-related developments for small business in 2015, and I am happy to provide you with an update, as well as to provide an outlook for 2016.

The most important development was the passage of *Protecting Americans from Tax Hikes Act of 2015* (PATH Act). This legislation, signed into law on December 18, 2015 as part of the year-end tax and appropriations agreement, permanently increased small business expensing levels to \$500,000, and adjusted them for inflation going forward.

NFIB has long advocated for a permanent increase in small business expensing, also known as "section 179 expensing" after its section in the tax code. It simplifies tax preparation and provides small business owners with an immediate deduction for investments that help businesses grow, which significantly improves cash flow. Since 2003, Congress steadily increased the allowable small business expensing amount from \$25,000 to \$500,000. Unfortunately, until this year, the expensing levels were only increased on a temporary basis, and at the beginning of 2015 they returned to \$25,000, which was woefully inadequate for the needs of small businesses.

Passage of the PATH Act ended the cycle of uncertainty, where small businesses would have to wait, often until the end of the year, before they knew how much they would be able to invest in their business. After passage of the bill, our President and CEO, Dan Danner, said this was "easily the most positive thing Congress has done for small business in the past several years, and it will ripple through the economy in the form of new investments and more jobs." Indeed, the NFIB Research Foundation

found that making this provision permanent will result in nearly 200,000 additional jobs, and an additional \$18.6 billion in economic growth.

In 2015, the House of Representatives also voted, for the first time in a decade, to permanently repeal the estate tax with the passage of H.R. 1105, the *Death Tax Repeal Act of 2015*. Repeal of the estate tax has also been a long-standing priority of small businesses. While the effect of the estate tax has thankfully been blunted in recent years due to the increase in the exemption level to, in 2016, \$5.45 million, and a reduction in the tax rate to 40 percent, its effect can still be felt by many small business owners. A recent NFIIB study found that, even with the higher exemption level, 34 percent of NFIIB members have incurred expenses in the last five years in order to protect themselves and their heirs from estate tax liability, and another 15 percent expect to do so in the future. The Senate has yet to vote on the *Death Tax Repeal Act*, and NFIIB will continue to advocate for action on this legislation in 2016.

The tax-related measures that were originally passed as part of the *Affordable Care Act* continue to have an impact on small businesses and will be a focus for NFIIB in 2016. For example, in 2015 the Internal Revenue Service (IRS) issued a regulation prohibiting healthcare reimbursement arrangements, which applies to certain types of employee payment plans including: health reimbursement arrangements (HRAs), flexible spending arrangements (FSAs) and certain other employer healthcare arrangements, where an employer reimburses an employee for some or all of the premium expenses incurred for an individual market health insurance policy.

Beginning on July 1, 2015 a business that reimburses more than one of their employees' individual health insurance policies will be penalized \$100 per day per employee (\$36,500 per year per employee), up to \$500,000. NFIIB is fighting to protect business owners from this egregious penalty and is working to reinstate flexibility in benefit offerings. Bipartisan legislation has been introduced in both the House and Senate to correct this serious problem, and we are hopeful that Congress will take action on this in 2016.

There continues to be significant discussion in Washington about tax reform. NFIIB has long advocated that tax reform must be undertaken "comprehensively," meaning that Congress should pursue tax reform that reduces the rate of taxation on all businesses, including pass-through businesses, and not just corporations taxed at the corporate tax rate. The reason for this is simple: the vast majority of small businesses are taxed as pass-through entities, with nearly 75 percent choosing a pass-through business structure. This means that most small businesses pay their taxes at the individual rate rather than the corporate rate. From a tax perspective, the pass-through model makes sense for the typical small business.

Today, the pass-through sector is extremely important to the U.S. economy, and in some ways has a larger economic footprint than the corporate sector. According to a recent study by the Tax Foundation, pass-through businesses earn more net business income than C-corporations. Additionally, they employed more than 50 percent of the private sector work force and accounted for 37 percent of total private sector payroll in 2011 (the most recent year that data is available). And in Kansas, pass-through businesses accounted for 53.3 percent of private sector employment in 2011.

In recent years, there has been some discussion in Washington about enacting "corporate-only" tax reform, where the corporate tax code would be reformed by eliminating many tax deductions, credits,

etc. in exchange for a lower corporate rate, but leaving the individual rate unchanged. However, if the rates were to go down for C-corporations but remain unchanged for pass-through businesses, it would put pass-through businesses at a competitive disadvantage relative to their corporate competitors.

In 2015, there was some discussion of an even narrower version of tax reform, focused on reforming the international tax system, and we expect that there will be continued discussions about this topic in 2016. This is due to a number of factors, such as the increasing number of corporate “inversions” (where a U.S. based company merges with another company based overseas and then relocates to a foreign domicile), and increased attention by European regulators on the tax treatment of some companies (including U.S. companies) by foreign governments. The incoming Chairman of the House Committee on Ways and Means recently said that he would like to take action on international tax reform before the end of the year. While small businesses are generally unaffected by changes in international tax policy, NFIB is working to ensure that small businesses are not adversely impacted in any “international-only” tax reform, or placed at a competitive disadvantage compared to their multi-national competitors.

We also expect that there will also be an increased focus on the tax platforms of the Republican and Democratic candidates for President in 2016. While many candidates have put forward tax plans of varying levels of detail, there are some common themes that emerge from their proposals. First, while Republican candidates for President have embraced comprehensive tax reform, they have generally rejected doing so in a “revenue-neutral” manner. Second, Republican candidates have generally embraced full expensing, where all businesses would be allowed to deduct the cost of equipment in the year that it is purchased, rather than depreciating it over time. Third, Democratic candidates have generally proposed significant increases in taxes, mostly focused on higher income taxpayers. These proposals will likely be debated over the course of the 2016 Presidential campaign, and could have an effect on the debate in Washington.

Whatever the outcome of the election, NFIB will continue to focus on ways to reduce the tax burden on small businesses, reduce the level of complexity that they face, and reduce their paperwork burden. Unlike a larger business, small businesses do not have a finance department or a staff of accountants and lawyers to focus on the nuances and changes in the tax laws. As a result, small business owners spend 5.5 billion hours, at an average rate of \$74.24 per hour, on tax compliance, the highest paperwork cost imposed on small business by the federal government. NFIB firmly believes that reducing these burdens should be a central focus in any tax reform efforts.

Thank you for inviting me to discuss these important federal tax issues and how they impact small businesses, and I look forward to answering your questions.

