KEEP IT SIMPLE: SMALL BUSINESS TAX SIMPLIFICATION AND REFORM, MAIN STREET SPEAKS

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC GROWTH, TAX AND CAPITAL ACCESS

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KEEP IT SIMPLE: SMALL BUSINESS TAX SIMPLIFICATION AND REFORM, MAIN STREET SPEAKS

WEDNESDAY, APRIL 13, 2016

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON ECONOMIC GROWTH, TAX AND CAPITAL ACCESS,
Washington, DC.

The Subcommittee met, pursuant to call, at 11:00 a.m., in Room 2360, Rayburn House Office Building. Hon. Tim Huelskamp [chairman of the Subcommittee] presiding.

Present: Representatives Huelskamp, Brat, Kelly, Chu, and Bishop.

Chairman HUELSKAMP. Good morning. I am pleased to be joined today, or at least later by our colleague, Representative Bishop. And he will join us later. But good morning. Thank you all for being with us today, and I call this meeting to order.

On Monday, April 18th, Americans will once again observe Tax Day. Small business owners across the country will be filing their tax returns, and for many small business owners, tax costs drive business decisions. The tax compliance costs currently imposed on small businesses are unacceptable. Employers with more than 50 employees face a tax compliance burden of somewhere between $182 and $191, while the smallest employers with one to five employees, spend between $4,308 and $4,736 per employee. Some of this difference results from economies of scale, but the difference is still astronomical. We should be encouraging our small businesses and helping them to succeed, not erecting barriers to block the way.

Every dollar that a small employer spends on tax compliance is a dollar that could have been used to invest back in the business or to hire another employee. Every hour that a small employer spends on tax compliance is an hour wasted that could have been spent on their actual business.

Today's hearing will focus on some of the most common and egregious areas of tax complexity that hinder small businesses in America. I expect we will also hear some recommended solutions—I hope so—and we will seriously consider them.

I would like to thank our witnesses for coming today. I look forward to your testimony. I now yield to Ranking Member Chu for her opening remarks.

Ms. CHU. Thank you, Mr. Chair.

With filing day upon us, many small business owners are sending in their tax returns or submitting requests for an extension, but in truth, the process never really ends for them. Constant changes to the tax code makes compliance a year-round challenge for small employers. For small businesses, outdated and increasingly complex rules create an obstacle to success, rather than a means of encouraging growth and job creation. Simplification and certainty are the driving forces in an endless effort to reform the tax code and ease the compliance burdens on small employers.

Through the years I have served on the Committee, we have heard many challenges created by the Internal Revenue Code and the major complications compliance has on business planning. We often hear that an intense focus on the bottom line is necessary to succeed. Small business owners know that every dollar counts, and they accordingly devote significant resources toward that goal.

And one area every small business owner must focus on is complying with our tax laws. Tax compliance disproportionately affects small businesses compared to their larger counterparts, which often have in-house tax services. The National Small Business Administration's Small Business Tax Survey found that over 30 percent of small firms spent more than 80 hours each year on tax compliance. It also concluded that nearly 60 percent of these businesses found administrative burdens to be the greatest complication and also the highest cost.

The tax compliance burden on small businesses takes many forms. Most notably is the complexity of the code itself. With many forms to fill out every year, the majority of firms either spend excessive resources and time filing their own taxes or hiring tax professionals. One way to address this problem is by simplifying the tax code. By reducing its complexity, small businesses would see decreases in these fixed costs, as the need for expert preparation and the time commitment to prepare are both reduced.

Congress did include the extension of important tax provisions in the PATH Act last year. By permanently addressing provisions like section 179 expensing, the R&D tax credit, and depreciation rules, small firms will now benefit from much needed certainty. It also serves as a spark to the economy as money saved now is injected back into the marketplace and long-term business plans can be created. But more can be done to simplify the tax code, preferably comprehensive tax reform. But until that day comes and we can agree on a solution, we must address some specific issues, like reducing paperwork requirements, updating filing deadlines, and other administrative caveats.

This hearing will give the Committee the opportunity to examine several general compliance burdens, as well as some specific areas that could be addressed now to make things just a little easier for small businesses in the near term.

I look forward to today's testimony and thank the witnesses for their participation. I yield back.

Chairman HUELSKAMP. Thank you, Ms. Chu.

If Committee members have an opening statement prepared, I ask that they be submitted for the record.

I would like to take a moment to explain the timing lights for each of you. You each have 5 minutes to deliver your testimony.

The light will start out as green. When you have 1 minute remaining, the light will turn yellow. Finally, at the end of your 5 minutes, it will turn red. I ask that you try to adhere to that time limit.

Our first witness is Mr. Troy Lewis. Mr. Lewis is a CPA, a managing member of Lewis and Associates in Draper, Utah, and chairman of the AICPA Tax Executive Committee. He is also an adjunct professor at Brigham Young University, where he received both a bachelor's and a master's degree in accounting. He is testifying today on behalf of AICPA and the Mobile Workforce Coalition. I appreciate you being with us today, Mr. Lewis, and you may begin.

STATEMENTS OF TROY K. LEWIS, MANAGING MEMBER, LEWIS AND ASSOCIATES, CPAS, LLC; MEL SCHWARZ, PARTNER AND DIRECTOR OF TAX LEGISLATIVE AFFAIRS, GRANT THORNTON, LLP; ROBERT M. RUSSELL, INTERNATIONAL TAX CONTROVERSY, PLANNING AND POLICY, ALLIANTGROUP; JULIE VERRATTI, DIRECTOR OF BUSINESS DEVELOPMENT/FOUNDER DENIZENS BREWING

STATEMENTS OF TROY K. LEWIS

Mr. LEWIS. Chairman Huelskamp, Ranking Member Chu, and members of the Subcommittee, thank you for the opportunity to testify today in support of H.R. 2315, the Mobile Workforce State Income Tax Simplification Act of 2015.

My name is Troy Lewis. I am a sole tax practitioner from Draper, Utah; an adjunct faculty member at BYU; and chair of the Tax Executive Committee of the American Institute of CPAs. I am pleased to testify on behalf of the AICPA.

H.R. 2315 is an important step towards State tax simplification for small businesses. This bill provides relief which is long overdue from the current web of inconsistent State income tax and withholding rules on nonresident employees. The rules are burdensome and often bewildering to small businesses and their employees. There are States that tax wages even if the employee only works for one day in that State.

Although some States provide a de minimis number of days or de minimis earnings amount before employers must withhold on these employees, these thresholds are not administered in any sort of uniform manner. For example, individuals are subject to State tax withholding after working 59 days in Arizona, 15 days in New Mexico, or just 14 days in Connecticut; yet, other States have a de minimis exemption based on the amount of wages earned. In Wisconsin, out-of-state employers are required to withhold State tax once an employee earns wages of $1,500. The cutoff is $1,000 in Idaho, $800 in South Carolina, and $300 a quarter in Oklahoma. Some States exempt and some do not income earned from certain activities, such as training and attending meetings. However, it is just not that simple. Exemptions sometimes only cover the employer's withholding requirement. They do not even start to address the employee's filing requirement or their tax liability.

Now, to be fair, it is true that approximately one-third of the States have entered into agreements under which one border State agrees not to tax another State's residents' wages and vice versa.

However, not all States have reciprocity agreements, and the agreements that do exist are primarily geared towards employees who ordinarily commute a few miles a day to particular adjoining States. For example, while Virginia has reciprocal withholding agreements with several States, California, Kansas, Mississippi, and New York, do not have any reciprocity agreements at all.

As CPAs, we see firsthand small businesses on Main Street, and their employees, getting caught up in this web of inconsistent State income tax and withholding rules. Consider a real estate developer whose employees visit 20 prospective States and 20 different sites and spend less than a day each year in those States. Or a store manager who attends a half-day regional meeting in another State, with some of these meetings only occurring maybe twice a year. Unfortunately, small businesses are forced to comply with all of the variations from State to State, and some States have extremely complicated rules.

Let's consider Georgia for a second. Georgia requires withholding when a nonresident employee works more than 23 days in a calendar quarter, or 5 percent of their total earned income is attributable to Georgia, or if the compensation for services there is more than $5,000 a year. So the employer has to determine and calculate each of those three separate thresholds to determine when to withhold on each employee who may occasionally work in that State.

The financial impact in most of these States is minimal. After taking into consideration their costs for processing nonresident tax returns, we believe those States receive only a minimal benefit, if any, from forcing out-of-state employees to file a return for just a few days' worth of work.

Small businesses currently face unnecessary administrative burdens to understand and comply with the variations from State to State. The issue of employer tracking and complying with all the different State and local tax laws is quite complicated. It takes a lot of time, not to mention the lost economic productivity for these small businesses.

Let's keep it simple. Let's provide small businesses relief from this egregious area of administrative complexity. Congressmen Bishop and Johnson have reached a very reasonable balance between the States' rights to tax income from work performed within their borders and the needs of individuals and businesses to operate efficiently in this economic climate. Their bill provides a reasonable and simple 30-day de minimis threshold which should apply uniformly across this country. We urge you to support H.R. 2315. This legislation should be passed as soon as possible.

Thank you for the opportunity to testify, and I would be happy to answer any questions you may have.

Chairman HUELSKAMP. Thank you, Mr. Lewis. I appreciate your testimony and your advocacy for that bill.

And I am now pleased to welcome Mel Schwarz, a partner and director of Tax Legislative Affairs in Grant Thornton's National Tax Office. He is both a lawyer and a CPA, so two strikes—I am just kidding—with more than 29 years of Federal income tax experience. He is an alumnus of the Joint Committee on Taxation, where he worked for 6 years. He holds a B.A. from SMU, a master's of accounting from the University of Texas, and a law degree

from the University of Michigan. Thank you for joining us today, Mr. Schwarz, and you may begin.

STATEMENT OF MEL SCHWARZ

Mr. SCHWARZ. Thank you, Chairman Huelskamp, Ranking Member Chu, members of the Subcommittee. I am grateful for the opportunity to speak to you today. As the title of the hearing says, "Small business needs tax reform." And simplifying compliance and administration for small business needs to be a part of that tax reform. It is an unfortunate fact that the complexity and cost of calculating many tax incentives makes it difficult for small businesses to properly take advantage of them. It is my experience that because of this, many small businesses are forced to ignore these incentives. This not only prevents the provisions from accomplishing their intended purpose, but also results in small businesses being placed at a disadvantage compared to their larger competitors, who are better positioned to reap the benefits by incurring the cost of calculation.

Now, one might say that the solution to this is to do away with tax incentives and to simply, really simplify, the code. When that happens that will be a wonderful thing, but until that happens, there really is an unfairness and a disadvantage for the small business community that is created by the complexity and not providing them an avenue to accomplish and to share in those incentives that for whatever reason Congress has chosen to include. It is my experience this leads many small businesses to believe that they have been left out, that the incentives in the code are intended for big business only, and that the system is simply not fair.

Now, we urge Congress to pursue tax reform that would lower the tax rates applicable to all business regardless of the form in which they conduct that business. Small businesses are among the most likely to organize as pass-throughs, and it is essential that pass-throughs, such as partnerships, S corporations, sole proprietorships, be included in any reduction in tax rates. But we also recognize the immense difficulty faced in enacting fundamental tax reform. And if for whatever reason such tax reform is not possible or is only possible in the future, simplification for small business should be addressed now by better focusing on methods that simplify computation and allow the use of safe harbors that are specific to the needs of small business.

Now, I am going to spend the rest of the time talking about two important Federal tax incentives: the Section 41 Research Credit and the Section 199 Domestic Production Credit. The credit for increasing research is one of the most effective incentives in the code. Studies have shown additional research contributes a multiple of its cost in increased economic activity. Now, under current law there are two methods that can be used to calculate the credit: a traditional method, which allows for a 20 percent credit but requires the use of data from as far back as 1984, or what they call an alternative simplified method. We tried a simplified method. We now need an alternative method. The credit is only 14 percent but we only have to use data from the prior 3 years.

Now, I talked with people who specialize in the research credit in my firm, and they said, in their experience, there are virtually

no small- or medium-sized businesses that use the traditional method, despite the fact that it provides a higher credit rate. Now, in recent years, there have been numerous legislative proposals to essentially abandon the traditional method, use whatever revenue could be raised by abandoning that method to increase the percentage allowed for the alternative simplified method. Enactment of that kind of legislation would provide a significant benefit to smaller taxpayers.

The research credit is also an example of an area where safe harbors designed for businesses in general could be better tailored to the needs of a small business. Example: Wages count as qualified research costs eligible for the credit to the extent the employee is engaged in research. Employees devoting 80 percent of their time to qualified research activities are considered to have devoted all of their time to such activities. Now, large businesses with significant research staffs can generally judge whether employees are spending substantially all of their time performing research, and then they can use this 80 percent rule more as a cushion, which allows them to say I feel comfortable and I feel safe with regard to that employee. I am going to include that employee's wage. In the case of a small business, typically each employee has a much wider range of responsibilities. Our experience is that this often prevents those small businesses from treating the 80 percent rule as a cushion the way their large business competitors are able to. Small businesses end up having to examine the credit and examine the documents to determine whether they qualify for the credit. If you were to reduce the safe harbor to 50 percent for small businesses, this would allow them to use the cushion in the same way their big business competitors use it, and this, I think, is an excellent example of the kind of change—by no means the only one.

My written testimony includes an example with regard to the domestic production activity deduction. I would be happy to address that separately, but once again, it is a complex calculation which does have safe harbors, but has safe harbors that fit the general business and are not specifically designed to facilitate the needs for small business.

Thank you, and I am happy to respond to any questions.

Chairman HUELSKAMP. Thank you, Mr. Schwarz.

Up next, I am pleased to welcome Robert Russell. Mr. Russell is an attorney with alliantgroup, specializing in international tax controversy, planning, and policy. He has a broad breadth of experience, having worked at the IRS, Treasury, and the Joint Tax Committee. He holds a bachelor's in accounting from Middle Tennessee University, a law degree from Chicago-Kent College of Law, and a master of laws in taxation from Georgetown. I appreciate you being with us today, Mr. Russell, and you may begin.

STATEMENT OF ROBERT M. RUSSELL

Mr. RUSSELL. Thank you. Thank you, Chairman Huelskamp, Ranking Member Chu, for having me here today to address the important issue of tax reform and simplification as it applies to small business. Specifically, today, I will address the challenges these businesses face when expanding and operating overseas and the burden imposed by the tax code.

As background, the firm I am with, alliantgroup, is a leading tax consulting firm helping American businesses grow through the tax code. Among our clients are thousands of small- and mid-sized businesses, including businesses from Kansas and California, and we work with CPAs throughout our work. If there is one message from my testimony today, it is that small businesses are, in fact, operating overseas, and they look to do more. However, the current tax code as written for international provisions is made for large companies.

Today, I would like to address three issues. First, the barriers for simple business functions that are imposed by the tax code, including those of information reporting. Second, the complexities in compliance costs that are in the code for these companies. And third, the need for international tax reform, both in the U.S. and globally.

To my first point, many of our businesses are shocked when they go overseas by simple business functions that are difficult because of our tax law. For instance, many of our clients are even unable to do simple things like open foreign bank accounts because foreign financial institutions do not want to deal with U.S. clients because of our Foreign Account Tax Compliance Act. For those taxpayers that do have foreign accounts, they have to run through the gauntlet of our U.S. tax reporting requirements. These requirements, you have to report to multiple U.S. agencies with different definitions of what to report, and they come with steep penalties. The hearing memo from the Committee included some of this information, but the penalties which were initially in place to ferret out those with secret accounts in Switzerland or Panama are now playing a game of "Gotcha" for those legitimate businesses operating overseas. These rules should be reexamined for appropriateness and simplicity. Furthermore, our clients tell us of international business opportunities being turned away when foreign partners actually tell them they take lesser quality goods from competitors so that they do not have to deal with the U.S. tax administrative burdens.

That brings me to my second point, that far too often in tax reform discussions and policy debates, the cost to taxpayers to comply is overlooked, especially when businesses expand overseas, the compliance costs skyrocket. I would like to give you one example from our client base. A specialty equipment manufacturer sees a market for his good overseas. He sets up an affiliate in this country for sales and distributions. This simple set up comes with a whole host of compliance costs. Under our transfer pricing rules, for this one enterprise, each transaction between the two entities must be evaluated for the price that would be charged on the open marketplace. Large companies are able to employ accountants, attorneys, economists, to provide extensive studies and analysis to meet the reporting requirements. There are no simplified reporting requirements for small businesses with resource constraints. In the past, alliantgroup has met with IRS and Treasury to try to discuss how to develop a way for smaller companies to meet their required reporting burden without being buried in compliance costs.

And to my final point, international reform and simplification. Everyone is in agreement that the current U.S. international tax code is in need of reform. I would just like to note that small business needs a place at this table during this discussion. With the

high rate of U.S. tax, small businesses that operate internationally, in fact, face some of the highest effective tax rates in the world. Large companies, we know, are able to engage in sophisticated tax planning, and it is well known they lower their effective tax rates, and they need to in order to compete globally. However, many small businesses are not able to do the same.

Lastly, within the reform discussion, I would like to mention the work globally recently by the OECD and their BEPS project. While many of the recommendations affect larger companies, I would just like to mention to keep an eye on the impact of some of these recommendations on smaller businesses. I provided a couple of examples in my written testimony, and I would be happy to get into some of those later. Thank you for allowing me to testify today on this important topic.

Chairman HUELSKAMP. Thank you, Mr. Russell. I appreciate the testimony. I look forward to questions on that.

I am now pleased to yield to the ranking member, Ms. Chu, so that she may introduce her final witness, Ms. Verratti.

Ms. CHU. Thank you, Mr. Chair. Let me also say that I have a Judiciary Markup occurring at this exact same time, so I may have to step out for a moment to vote, but I will be back.

But now, it is my pleasure to introduce Ms. Julie Verratti, director of business development and founder of Denizens Brewing in Silver Spring, Maryland. Denizens is the only women and minority-owned and operated brewery in Maryland. Prior to starting her business, Ms. Verratti was a presidential management fellow at the Small Business Administration and staffer with the Senate Small Business and Entrepreneurship Committee. She received her undergraduate degree from Brandeis University, and her law degree from the George Washington University Law School. Ms. Verratti is testifying on behalf of the Brewers Association, an organization of brewers for brewers and by brewers. Welcome, Ms. Verratti.

Chairman HUELSKAMP. I thank the ranking member for that introduction. Ms. Verratti, you may begin.

STATEMENT OF JULIE VERRATTI

Ms. VERRATTI. Thank you. Chairman Huelskamp, Ranking Member Chu, and members of the Subcommittee, thank you for the opportunity to testify at today's hearing.

My name is Julie Verratti. I am the director of business development and cofounder of Denizens Brewing Company in Silver Spring, Maryland. I am here today speaking on behalf of my small business and the Brewers Association, which represents more than 3,000 craft brewers. My cofounders, Emily Bruno, Jeff Ramirez, and I, started Denizens in 2014, and we are the only women and minority-owned and operated brewery in Maryland. We are both a restaurant and a production brewery, which means that we produce beer to be sold both in our restaurant and to other retail locations. In the short time that we have been open, our brewery has experienced solid growth. In 2015, we produced 1,140 barrels of beer and are on track to produce about 1,500 barrels in this coming year. For anyone who is curious, that equals about 82,500 six-packs.

Running a craft brewery, like Denizens, is similar to running any other small business. All the day-to-day activities and stresses, like scheduling, marketing, health care, and payroll, they are all amplified by a tight brewing schedule and working to distinguish ourselves in a growing industry.

Denizens has close to 40 full-time employees, who range from tip service positions, kitchen staff, brewing staff, and salaried professional positions. All of our full-time employees are offered medical, dental, and vision insurance through the company, which is something we are very proud of.

Denizens produces beer in Maryland, and we sell our beer both in Maryland and D.C. Our tax and compliance burdens are significant. We collect and submit sales tax in our tap room. We pay employment taxes, business income taxes, and on top of that, excise taxes to both the State and Federal Governments using their separate and individual filing systems. I spend up to 11 hours a month working on taxes, which may not seem like a lot of time, but it is significant when you are working to grow your business. And in the next month, my brewery will start distributing in Virginia, which will increase the number of tax regulations that we must comply with. We are happy to comply, but these tax burdens could be a deterrent for a smaller brewery than Denizens.

Currently, breweries are required to comply with a patchwork of Federal, State, and sometimes even county taxes and alcohol regulations. Oftentimes, there are different requirements about when and what to file. For example, Denizens files taxes biweekly, monthly, quarterly, and annually, although we have received some relief from the Federal Government that I want to discuss further.

In many cases, we have found that even if there is a way to file online, it is actually easier to file the forms in hard copy. It would be significantly more convenient if the Federal and State Governments worked together to come up with a more streamlined process for reporting. In fact, a large portion of my time spent on taxes is actually duplicating information from one report to another.

The Federal Government has taken the steps to correct some of the burdensome biweekly excise tax filing requirements. Last year, language was included in the year-end tax extenders package that made it so any alcohol producer that pays less than $50,000 in annual Federal excise taxes, will no longer be required to get a bond and will only need to file quarterly. Another step that the government took that was beneficial to both my brewery and others like mine, was to permanently extend the small business expensing limitation and phase-out amounts in section 179 when they passed the PATH Act. Because of this change, we were actually able to save on a combination of equipment purchased in 2015 and a carryover from 2014.

As I mentioned previously, breweries like mine pay excise taxes on both the State and Federal level. These are additional taxes over and above our business and payroll taxes, and one of the major expenses that I, as a brewery owner, face.

When the Federal beer excise tax was first put into place to finance the Civil War, excise taxes were a major source of revenue, and most other modern Federal taxes did not exist. For almost a decade, the Brewers Association has been working with Congress

to try and pass legislation that recalibrates the Federal Excise Tax to reflect the makeup of the craft brewing industry and to spur additional growth. The Craft Beverage Modernization and Tax Reform Act introduced this Congress would lower the Federal excise tax for the brewing industry, as well as the wine and distilled spirits industries, and make the alcohol beverage excise tax system more progressive for smaller producers like Denizens. It is legislation like this that would have a major impact on my business, as well as other craft brewers. Denizens is a growing brewery, and if we continue at our current trajectory, we will be at capacity within the next 2 years. If we are able to get our Federal tax lability reduced, we will be able to produce more equipment and kegs and hire at least two additional new full-time employees.

Knowing that we would have access to additional capital is an incentive to continue growing and hiring, which will produce more Federal revenue over time. A reduced Federal excise tax liability would be extremely helpful to the craft brewing industry and the national economy. It is no surprise that this bill has widespread bipartisan support from not just the alcohol industry but also agricultural and manufacturing associations.

In conclusion, taxes and tax compliant costs are the largest expenses that craft brewers, like Denizens, deal with on a day-to-day basis. We are more than happy to pay our fair share, but recalibration of the Federal excise tax would have an extremely positive impact on small brewing businesses like mine and also the ones that are in your home States.

Thank you again. I appreciate the Subcommittee inviting me to testify today, both on behalf of Denizens Brewing Company, the Brewers Association, and the many craft brewers across this country.

Chairman HUELSKAMP. Thank you, Ms. Verratti. I appreciate your testimony, each of the witnesses here today, and of course, our topic here is tax simplification for Main Street. And with that, I will start with a question for Mr. Lewis, if I might.

If you were able to wave a magic wand—we do not do that very often around here but we talk about it—what would be you think the single most important change we could make on tax simplification that would help Main Street businesses?

Mr. LEWIS. The single most. Well, that is, as you said, the wand business is far from here. I would say you heard a recurring theme up here, which is to cut out the administrative burden. I think that is the key. I think Ms. Verratti echoed what me and my clients say is the same thing. They are happy to pay what they owe. They just would like to do it with a lot less effort. There is unproductive time that is spent in complying, and I think that goes to the issue of tax simplification. Some of the other ones are more burrowed up into it, but in the end, what they are really saying, what we are hearing on Main Street is just lower the burden. Lower the burden on administrative compliance and you will be doing a great deal for them.

Chairman HUELSKAMP. Mr. Lewis, when the IRS issues regulations and rules, do they make estimates of tax compliance costs or is that from the private sector?

Mr. LEWIS. There is a process by where they do try to estimate the time to comply, but it is just like everything else with the bureaucracy with which we live. The door only swings one direction usually with that stuff. We just add to the process; we do not take away. And so I am not here to advocate to say that any one particular regulation or a new particular thought is wrong but you just have to understand that it adds to the existing burden that is already there. And when you put that burden on those companies, what you are really doing is you are having them reallocate resources from growing their business and hiring new people and doing the things that you want them to do from this Committee and the things that you espouse from this Committee's level, and instead, they just put it in nonproductive ways, like complying.

Chairman HUELSKAMP. Mr. Schwarz, you raised the issue of safe harbors and I will say your explanation of safe harbors, which are alternative to simplification, seem quite complex. Is there any way we could structure, actually do that to make safe harbors a means for simplification? I know we are trying to target the small businesses here, but can you describe that a little more in-depth? If you were able to change that, how would you apply those and simplify those?

Mr. SCHWARZ. What you are looking for any time a safe harbor is created for the Federal tax system, is to allow taxpayers to essentially shortcut what would otherwise be a very complex calculation. And that is where I think you want to see an expansion of that type of activity. Ask the question each time that a rule is put in place: is there a simple way to address this issue so that instead of going through a detailed calculation, instead, something that is simple, maybe something that can be drawn directly from the financial records that are being kept. One of the problems that small businesses face is that unless they keep their books entirely on a tax basis, which the banks are not always happy with, then they are keeping two sets of books. And the more they could be allowed to use their financial book, so long as that is a reasonable method, then I think the simpler it would be.

Ms. Verratti has, I think, a classic example with regard to we did not get into the domestic production activity deduction, but because she runs—both brews beer and sells it at a restaurant, if she just brewed beer, all of her revenue would qualify. We would just take 9 percent off the top. But because she has two functions, one of which qualifies, one of which does not qualify because they did not want McDonald's to qualify, she is faced with having to do a separation. He could we make that separation easy? How could we put in a rule that she would be comfortable using that would say, okay, I have got this one statistic; I apply that statistic and I know the IRS will accept it?

Chairman HUELSKAMP. Do you think the IRS has the capacity to figure that out?

Mr. SCHWARZ. Yes. I think that they do.

Chairman HUELSKAMP. Okay.

Mr. SCHWARZ. The question, of course, is will they?

Chairman HUELSKAMP. Yeah. Very good.

Mr. Russell, you made a pretty stunning, but I think accurate, statement that in terms of our rules and regulations, particularly

for overseas business, they have been built for large corporations. Is that by statute, or rule and regulation, or simply simplification for the IRS?

Mr. RUSSELL. Well, the statute is actually very broad in this area, and so it is left to Treasury and IRS to implement. And they look for the information that they need; however, they have not scaled it back to meet small business needs. And there are some examples of other countries that have systems in place to reduce documentation requirements for these size businesses, which could be done. Resources are available to have this conversation and to facilitate business.

Chairman HUELSKAMP. Thank you. I will next yield to Representative Trent Kelly for 5 minutes of questions.

Mr. KELLY. I am a southerner. We do terrible with any names that have more than two syllables, but Ms. Verratti, thank you, first of all, for being a woman-owned and minority industry. I think that is so important, and thank you for your conversations. You mentioned during your testimony that you spend 11 to 12 hours a week—a month, which is a significant amount. That being said, you obviously have some basis—when I was in law school and I took Tax, what I learned was I can recognize and identify a tax problem three out of four times and I can solve none of them, but you obviously have some expertise. Most people do not so they are not able to give, even if they had 11 hours to give, they cannot. Do you have any expertise that allows you to do the tax?

Ms. VERRATTI. I would say the expertise that allows me to do the taxes. The way I do it is that I used to work for the government, so I understand what government people are looking for when filling out forms. So that is helpful to me. Obviously, my educational background as well is helpful. I think there are a lot of small business owners out there who do not necessarily have—I mean, I was lucky enough to be able to go to law school, so yes, I think that the number one thing that is frustrating with the tax forms that we fill out—and I say "we" meaning all the craft brewers across the country—is that a lot of the language in the forms and the directions, so to speak, that are supposed to be explaining to you what they are actually asking, does not make any sense. There is not enough plain language, so I think that that would actually be a great way to explain the system, is having all the directions in plain language. I mean, I am someone with a law degree and I sometimes read these forms and I am like, I have no idea what they are asking me to do. So I think that that would be a really helpful thing to improve the system.

Mr. KELLY. And Mr. Schwarz, going to the same kind of question here, most small business owners do not have the expertise or the education level in that specific area of taxes and those things. And if they are spending, someone who is a professional and understands can spend 11 or 12 hours a month, the expenses to a regular—and those are not paid for any other way. I mean, that just comes down as cost to customers; is that correct? And what would you do to improve that?

Mr. SCHWARZ. That is certainly correct, Congressman.

Mr. KELLY. What, if anything, would you do, or how do we better simplify? You know, there are simple solutions to complex prob-

lems. I think sometimes agencies and even congressmen forget that, but there are simple solutions. So what are some simple solutions that you think will help this?

Mr. SCHWARZ. Again, I will come back to the idea that to the extent possible you want to have one set, one—you calculate things once. And calculating however you calculate it, whether it be using—how can we allow the tax rules to follow something that the business is already having to do? That, I think, would be significant. The other is to look at each section, and not only ones that are in the law but as things come into the law and say, okay, is there someway here that we could allow a shortcut, that we could allow small business to have that certainly for revenue estimation reasons you might not be able to extend to the entire world, but for small business to preserve their ability to deal with that particular provision. And I would hope that this is an area where this Subcommittee could make a real role in standing up for the needs of small business in that kind of a context.

Mr. KELLY. Mr. Chairman, I first thank all the witnesses for being here and for your testimony, and Mr. Chairman, I yield back.

Chairman HUELSKAMP. Thank you, Representative Kelly. Next, I yield to Representative Chu, returned from her markup, and you have 5 minutes for questions.

Ms. CHU. Well, I would like to ask the entire panel about resources for the IRS and how it could better serve you. The budget proposal for the IRS for Fiscal Year 2017 is $11.8 billion; however, the IRS requested $12.3 billion in order to dedicate an adequate amount to resources and staff to improving customer service and technology. Now, I understand better taxpayer service and education leads to higher compliance rates, and what I would like to ask about is what kind of customer service have you experienced from the IRS, and what are your thoughts about where improvements could be made, especially with regards to small business.

Mr. LEWIS. Thank you, Ranking Member Chu. It is still a little bit early for us to have feedback at the AICPA. We do a fairly sophisticated informal survey of our members right after busy season ends. As you can imagine, emails are not getting returned very quickly today by our members. They will be next week; I guarantee that. But I would say based on my personal experiences, they have improved year over year. Last year was abysmal, and that is in the commissioner's words, not mine. This year, instead of waiting 2 hours on the phone, the last time I called it was like 12 or 13 minutes. So I have seen an increase. And again, we have just talked a lot about the small business inefficiencies. Do not forget that I represent CPAs that have their own small businesses just like mine. The inefficiencies that we heard from Ms. Verratti plague us, too. No one wants to sit on the phone listening to the same repetitive three-song track over and over again for 2 hours, although as a side benefit, I have become a classical musical fan. But it is not productive time. It is not what my clients expect me to do, and it is not what I want to be doing.

So to answer your question, the IRS has got to be more efficient in what they do. They have to be more effective. They have to find the ways to help the taxpayers, but also those that serve them, the tax professionals. I have seen it improve in my own experience over

this last year, and it is a complicated question. It is hard to tell exactly what the benefits all are, but I would say that it is better.

Mr. SCHWARZ. I would agree with Mr. Lewis, but I would say that there is still work that could be done, and there is improvement that could be made. And, unfortunately, that always involves additional money. And I think it would benefit, in particular small business, who may be more likely to need to rely on direct contact with the sort of IRS phone system, that it would be helpful if there were additional funds available.

Having said that, I think there is also, it is noteworthy and I know that the commissioner is coming to speak to you later this afternoon, but there are initiatives to modernize and make more efficient the taxpayer-IRS interface, particularly through a growing use of computer-aided and Internet-focused activities. It is always important to remember that for particularly the smallest of the businesses, that may not be an efficiency that is always available to them, and the ability for any taxpayer to access the IRS needs to always be there, whether or not they have access to a computer.

Mr. RUSSELL. And everyone recognizes that the IRS is stretched thin, but speaking to our CPAs and clients, I mean, they are looking for more help from the IRS—more guidance, more educational outreach, and additional people trained to talk to on the other end of the phone. I will say in my practice, I represent clients with international tax issues, and yes, there is a little frustration, even for myself, who has been on the IRS side examining returns. I know who I need to talk to. I cannot get on the phone to talk to the right person. So there is a little frustration in that point.

One point I will add is the help of the National Taxpayer Advocate in this system. So whenever you are talking about helping the IRS, more funds, that is one angle that is very helpful in this, too.

Ms. VERRATTI. I will say that I am somewhat neutral in terms of I have never really had to deal with the IRS in terms, so I cannot really judge their customer service. I will say another part of the government that is somewhat related is the Alcohol and Tobacco Tax and Trade Bureau, otherwise known as the TTB. I would absolutely advocate for and encourage you guys to fully fund them, help them get more staff, especially as the craft brewing industry is growing in this country. It is an industry that is booming and there are more and more people needing more and more guidance from that agency. And more and more labels that need to be improved. And I guess I will stop there.

Ms. CHU. Okay, thank you. I yield back.

Chairman HUELSKAMP. Thank you, Representative Chu. Next, I recognize Representative Mike Bishop from Michigan. Welcome to the Committee. Thank you for joining us, and you have 5 minutes.

Mr. BISHOP. Thank you, Mr. Chairman. Thank you very much for inviting me to be a part of this Committee even though I am not an actual member. I am grateful for your invitation, and thank you Ranking Member Chu for your hospitality today. I also want to thank you for accommodating my schedule. In Judiciary we had a markup, so thank you very much for letting me wear my track shoes today and run in this very easily navigated Rayburn building as we all know.

I have been a business owner, a small business owner and an attorney for more than 2 decades, and part of those 2 decades as general counsel for a small business, so I am very familiar with these issues. I have seen firsthand how complicated and confusing and burdensome the State income tax system is for businesses, especially those with employees working for temporary periods in multiple States. This compliance burden is even higher for small businesses because they do not have large legal or payroll departments to help them keep track of the 40 different State income tax rules.

Small businesses and their workers should not be punished with the complex tax reporting standards simply because our modern economy means more work travel across State lines. Such policies are detrimental to businesses themselves, but also to the economy. Instead of adding jobs or reinvesting, small business owners are forced to spend time and their resources on complying with convoluted State income tax laws. I can tell you firsthand as a general counsel, we spent most of our time on compliance, looking over our shoulder to see what regulator was going to come at us next and for what reason. And if you had three regulators call in one day, they would all disagree with each other or give their different opinions on any particular rule.

One particular story from an employer that we had in Judiciary really stands out in my mind. Last year, a gentleman came to the Subcommittee in Judiciary. He was an employer. He had filed 10,500 W-2s on behalf of their employees, primarily because they had crossed State lines during the course of business. He explained a case where one worker had to file 50 W-2s. Just imagine a small business having to file 50 W-2s. We should not be placing that burden on our small businesses. It really is absurd.

The bill that Mr. Johnson and I introduced, H.R. 2315, the Mobile Workforce State Income Tax Simplification Act of 2015, quite a mouthful, is carefully crafted legislation that creates a simple and easy to administer system for the imposition of a nonresident State income tax law by creating a uniform 30-day rule to determine nonresident income tax liability. The bill ensures employees will have a clear understanding of when they are liable for nonresident State income tax and small business employers will be able to better withhold these taxes. It will save time and resources, allowing businesses to put their hard-earned resources towards things that drive our economy forward, such as jobs and investment. That really is the underlying goal of the bill.

I want to thank everybody in this room because I know you all stand for small business and you are doing everything you can to make this a better environment. I think this is a good bill. I would just throw out there, if I could, Mr. Lewis, for your thoughts about how this will impact small business. Bigger businesses have an opportunity to absorb this, may have a better, easier way of dealing with it. Small business does not. Can you quantify that for us and tell us the impact it is having?

Mr. LEWIS. Sure. Thank you, Representative Bishop, and thank you for your leadership on this important piece of legislation and your cosponsorship. Also, the chairman as well for cosponsoring.

I think to understand this legislation, you have to understand two parts. The first is there is a part that the employer has to deal

with and then there is the employee. Let's deal with the employer first. The employer has to be educated about all the various State laws, and as I said in my opening testimony, there are varying rules and the rules change. So that constant educational process is taking these business owners and these administrative people away from the function of running their business. How hard is it? It is just as you said; the smaller the business, the more they have to spread—they have the least amount of ability to spread those costs. It is incredibly burdensome.

And to the chairman's question, what is the most important thing you do? Just cut the administrative burden. I think that is key. But let's do not forget that there is an employee aspect as well. Even after this employer has filed 50 W-2s on behalf of one employee, that employee then has to turn around and file, potentially, in all of those various jurisdictions. Keep that in mind. So it is not just burdening the small business but it is the employees as well. So it is incredibly burdensome, and I think it has come time to where let's just, as Mr. Schwarz said, let's look for a cost-benefit. Let's look at these types of things with a cost-benefit lens. Is the benefit really that great that we should burden these individual employees and these small businesses? I would suggest not, and that is why I think this legislation is a good piece.

Mr. BISHOP. Thank you.

Mr. Chairman, I know we are over. May I make a request in asking unanimous consent to submit into the record before we leave today Representative Johnson, who cannot be here today, his testimony? Thank you.

Chairman HUELSKAMP. I would like to thank all of our witnesses for participating today. You have raised a number of issues and potential solutions. I do like hearing that. That requires serious consideration. Clearly, these are not the only areas of undue tax complexity for small business, but putting a spotlight on these issues is a good start. I am pleased to be a cosponsor of our colleague, Mr. Bishop's Mobile Workforce Bill, which I hope will help us make some headway, and I urge my colleagues to join as well. This Subcommittee remains dedicated to small businesses and their hard-working employees. It is incumbent upon us to ensure that small businesses have the tools they need to succeed and are not mired in compliance complexities. It is a clear example where we need to get government out of the way. If our tax code is not helpful to our small businesses, it should at least be clear.

I ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record. Without objection, so ordered.

This hearing is now adjourned.

[Whereupon, at 11:50 a.m., the Subcommittee was adjourned.]

APPENDIX

AICPA®

American Institute of CPAs
1455 Pennsylvania Avenue, NW
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April 7, 2016

The Honorable Tim Huelskamp
Chairman
Subcommittee on Economic Growth, Tax, and Capital Access
U.S. House Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Judy Chu
Ranking Member
Subcommittee on Economic Growth, Tax, and Capital Access
U.S. House Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515

RE: AICPA Statement for the Record of the April 13, 2016 Hearing on "Keep It Simple: Small Business Tax Simplification and Reform, Main Street Speaks"

Dear Chairman Huelskamp and Ranking Member Chu:

The American Institute of CPAs (AICPA) respectfully submits the attached statement for the record of the House Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access hearing on April 13, 2016 on "Keep It Simple: Small Business Tax Simplification and Reform, Main Street Speaks." Our testimony focuses on the importance of H.R. 2315, the Mobile Workforce State Income Tax Simplification Act of 2015.

The AICPA is the world's largest member association representing the accounting profession, with more than 412,000 members in 144 countries and a history of serving the public interest since 1877. Our members advise clients on federal, state and international tax matters, and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized business, as well as America's largest businesses.

We welcome the opportunity to discuss the mobile workforce legislation or to answer any questions that you may have. I can be reached at (801) 523-1051 or tlewis@sisna.com; or you may contact Eileen Sherr, Senior Technical Manager – AICPA Tax Policy & Advocacy, at (202) 434-9256, or esherr@aicpa.org.

Sincerely,

Troy K. Lewis, CPA, CGMA
Chair, AICPA Tax Executive Committee

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THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

WRITTEN STATEMENT FOR THE RECORD

OF THE HEARING BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON SMALL BUSINESS

SUBCOMMITTEE ON ECONOMIC GROWTH, TAX, AND CAPITAL ACCESS

On

Legislative Hearing on
"Keep It Simple: Small Business Tax Simplification and Reform, Main Street Speaks"

April 13, 2016

INTRODUCTION

The American Institute of CPAs (AICPA) commends Chairman Huelskamp, Ranking Member Chu, and Members of the Subcommittee for examining the need for, and potential benefits of, small business tax simplification and reform, including a bill that would assist small businesses, H.R. 2315, the Mobile Workforce State Income Tax Simplification Act of 2015. We applaud the leadership taken by the Committee to consider this important legislation.

The AICPA is the world's largest member association representing the accounting profession, with more than 412,000 members in 144 countries and a history of serving the public interest since 1877. Our members advise clients on federal, state and international tax matters, and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

The AICPA is also an active leader in the national Mobile Workforce Coalition, comprised of 295 businesses and organizations that support this legislation.

H.R. 2315

The AICPA commends the Subcommittee for their consideration of H.R. 2315, which limits the authority of states to tax certain income of employees for duties performed in other states. More specifically, the bill prohibits states from taxing most nonresident employees (there are exceptions for certain professions) unless the employee is present and performing employment duties for more than 30 days during the calendar year. Furthermore, employees would not be subject to state income tax withholding and reporting requirements unless their income is subject to taxation.

AICPA'S POSITION

The AICPA strongly supports H.R. 2315. We believe the bill provides relief, which is long-overdue, from the current web of inconsistent state income tax and withholding rules that impact employers and employees.

After taking into consideration the costs for processing nonresident tax returns with only a small amount of tax liability, we believe states receive only a minimal benefit (if any) from the tax revenue that results from an employee filing a return for just a few days of earnings in that state. If nonresident tax returns with minimal income reported were eliminated through a standard, reasonable threshold, such as in H.R. 2315, we think that most states would have an increase in resident income taxes to substantially offset any decrease in nonresident income tax revenue (assuming workers both travel to and out of the state for work). In other words, the current system as a whole unnecessarily creates complexity and costs for both employers and employees, without yielding a substantive benefit to most states. Sixteen states, such as Kansas, would either have no or minimal revenue loss, and 18

states would, in fact, have a positive revenue gain from this legislation. Most importantly, according to estimates of the impact of the bill, the net change as a percentage of total state taxes for all states is only -0.01, a $42 million net change for all states.[1]

We believe Congressmen Bishop and Johnson have reached a reasonable balance between the states' rights to tax income from work performed within their borders, and the needs of individuals and businesses, and especially small businesses, to operate efficiently in this economic climate. Having a uniform national standard for nonresident income taxation, withholding and filing requirements will enhance compliance and reduce unnecessary administrative burdens on businesses and their employees. In addition to uniformity, H.R. 2315 provides a reasonable 30-day *de minimis* exemption before an employee is obligated to pay taxes to a state in which they do not reside.

H.R. 2315 is an important step towards tax simplification for state income tax purposes for small businesses. Therefore, the AICPA urges Congress to establish (1) a uniform standard for nonresident income tax withholding and (2) a *de minimis* exception from the assessment of state income tax as provided in H.R. 2315. This legislation should be passed as soon as possible.

BACKGROUND

The state personal income tax treatment of nonresidents is inconsistent and often bewildering to small businesses and their employees. Currently, 41 states plus the District of Columbia impose a personal income tax on wages, and there are many different requirements for withholding income tax for nonresidents among those states. There are seven states that currently do not assess a personal income tax, and two states that do not tax wages and only tax interest and dividends of individuals.[2] Employees traveling into all the other states are subject to the confusing myriad of withholding and tax rules for nonresident taxpayers. These rules on a state to state basis vary so much that it is impossible to predict or to even guess what one state may hold as its own rules.

Some of the states have a *de minimis* number of days or *de minimis* earnings amount before employers must withhold tax on nonresidents, or nonresidents are subject to tax. These *de minimis* rules are not administered in a uniform manner. For example, for 2015, a nonresident is subject to income tax withholding in certain states based upon an entirely different threshold, such as, after working 59 days in Arizona, 15 days in New Mexico, or 14 days in Connecticut.[3]

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[1] See Statement of Statement of Douglas L. Lindholm, President & Executive Director, Council On State Taxation (COST), Before the U.S. House of Representatives Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial and Antitrust Law, Hearing on H.R. 2315, The Mobile Workforce State Income Tax Simplification Act of 2015, June 2, 2015, Exhibit C, pp. 1-2.

[2] These seven states have no personal income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. New Hampshire and Tennessee are the two states that do not tax wages and only subject to tax interest and dividends earned by individuals.

[3] See *Payroll Issues for Multi-State Employers,* 2015 ed., American Payroll Association, pp. 4-1 et seq.

Other states have a *de minimis* exemption based on the amount of the wages earned, either in dollars or as a percent of total income, while in the state. For example, for 2015, employers generally are required to withhold in a nonresident state once an employee earns, or is expected to earn, taxable wages of $1,500 in Wisconsin, $1,000 in Idaho, $800 in South Carolina, and $300 a quarter in Oklahoma.[4] Other states that have thresholds before nonresident withholding is required are Georgia, Hawaii, Maine, New Jersey, New York, North Dakota, Oregon, Utah, Virginia, and West Virginia.[5] Some of these states' thresholds are set at the state's personal exemption, standard deduction, or filing threshold, which often change each year. The remainder of the state tax income earned within their borders by nonresidents, even if the employee only works in that state for one day.

Some states exempt, and some do not exempt, from the withholding requirement, the income earned from certain activities, such as training, professional development, or attending meetings. Note that some of the states only cover exemptions from state withholding, and as a result, they do not address the nonresident taxpayer's potential filing requirement and tax liability in a state or local jurisdiction. Furthermore, only a minority of states use day or income thresholds—and without any uniform standard.

It is also important to note that approximately one-third of the states (mostly bordering each other in the Midwest or East) have entered into reciprocity agreements under which one border state agrees not to tax another border state's residents' wages, and vice versa. Accordingly, the in-state resident does not need to file a nonresident border state return, and the employer does not have to withhold non-resident income taxes with respect to the in-state resident, even if the in-state resident primarily works in the nonresident state. Some type of an "exemption form" is often required to be filed in each nonresident border state.

However, not all border states have reciprocity agreements. For example, no reciprocity agreement exists between Maryland and Delaware. Therefore, both Maryland and Delaware require withholding, the payment of taxes and the submission or a tax return for a car salesman who lives and primarily works in Ocean City, Maryland but occasionally has to drive to another dealer in Rehoboth Beach, Delaware.

Unfortunately, the existing reciprocity collaboration between some border states provides only patchwork relief with two-thirds of the country not covered by such agreements. Furthermore, the current agreements are primarily geared toward nonresident employees who ordinarily commute a few miles a day to particular adjoining states in which their employer is located. For example, while Virginia provides reciprocal withholding agreements with the District of Columbia, Kentucky, Maryland, Pennsylvania, and West Virginia, other states, such as California, Kansas, Mississippi, and New York do not provide any reciprocity agreements with neigh-

[4] Ibid.
[5] Ibid.

boring states. The reciprocity rules generally do not apply to individuals who regularly travel greater distances.

However, in today's economic environment, it has become quite common for employees to travel for short periods of time to other states.

TYPES OF INDUSTRIES AND TAXPAYERS IMPACTED

These complicated rules impact everyone who travels for work. All types and sizes of businesses are impacted. Large, medium, and small businesses all have to understand each of the states' treatment of nonresident employee withholding and assessment of taxes and the unique *de minimis* rules and definitions. This issue also affects all industries—retail, manufacturing, real estate, technology, food, services, etc.

Some everyday examples include a real estate developer's employee who travels to 20 states to visit prospective sites and spends less than a day in each state, or a store manager who attends a half-day regional meeting in an adjoining state, with some of these meetings occurring only twice a year. Since there are states in which there currently is no minimum threshold, an employee's presence in that state for just one day could subject the employee to state tax withholding.

In addition, accounting firms, including small firms, conduct business across state lines. Many clients have facilities in nearby states that require on-site inspections during an audit. Additionally, consulting, tax or other non-audit services that CPAs deliver are frequently provided to clients in other states, or to facilities of local clients that are located in other states. In essence, all of these entities (small businesses, accounting firms and their clients) are affected by nonresident income tax withholding laws.

HYPOTHETICAL EXAMPLE

For example, assume an employee earns $75,000 a year, resides in Maryland, and travels to work in Indiana, Kansas, Massachusetts, and Ohio for 5 days each in a given tax year. Assume further that the taxpayer earns a pro rata amount of salary in each of the states of $1,500 ($75,000 * 5 days / 250 total workdays = $1,500).

Without the Mobile Workforce legislation, the employer currently must withhold on all of the employee's income in Maryland (the resident state) and the source income from different jurisdictions (which for all practical purposes, will only occur if the employer has a sophisticated time reporting system in place and the employee correctly reports the number of days worked in each state.)

Despite the relatively small amount of income in each of the nonresident states, some amount of tax is likely due in each of the states. The employer must withhold in all five states, and the employee then must file in addition to the federal tax return, income tax returns in Maryland (as a resident), and as a nonresident in Indiana, Kansas, Massachusetts, and Ohio, all of which require nonresident withholding on the first day of work in that state. De-

pending on the tax withheld, the nonresident state income tax returns may yield a small refund or a small additional tax payment.

While the Maryland return yields a refund, it becomes particularly complex because the employee is required to file forms showing the credit for taxes paid to each nonresident state, and Maryland does not always provide the employee with a dollar-for-dollar credit when factoring in the Maryland county-level tax required to be paid. The federal tax return also becomes more difficult because of the numerous state tax payments and refunds that impact deductions and adjustments for the state tax deduction (for alternative minimum tax purposes, for example).

The administrative burden of filing in five nonresident states, along with the complexity of the withholding rules for each state, would probably require utilization of a third-party service provider that assists with processing payroll for businesses (resulting in additional costs to the employee). The Mobile Workforce legislation makes it significantly easier for the employer and the employee from a compliance perspective. The taxpayer files one state income tax return in Maryland, and it is a more straightforward return (without calculations and credits for nonresident state taxes paid).

CHALLENGES FOR EMPLOYERS

Employers currently face unnecessary administrative burdens to understand and comply with the variations from state to state. For example, employers are responsible for determining whether to subject an employee to withholding in a state if the employee attends out-of-state training for a couple of days, or how to account for an employee responding to business calls and e-mails on a layover in an airport. Employers also need to consider whether to withhold taxes in a state for when a employee is working on a train that travels into multiple states and jurisdictions in the Northeast Corridor, or what happens when an employee working at a business located close to a state border must cross the state line for a quick mundane task.

The issue of employer tracking and complying with all the differing state and local laws is quite complicated. The employer and employee need to be aware of the individual income tax and withholding rules of each state to which that the employee travels, including whether the state has, and if the employee has exceeded, a *de minimis* threshold of days or earnings, and if there is a state reciprocity agreement that applies. Some states have extremely complicated rules for determining when to withhold for a nonresident. For example, Georgia requires withholding when a nonresident employee works more than 23 days in a calendar quarter in Georgia, or if five percent of total earned income is attributable to Georgia, or if the remuneration for services in Georgia is more than $5,000. The employer must determine and calculate each of the three thresholds to determine when to withhold for each employee working occasionally in that state.

The recordkeeping, especially if business travel to multiple states occurs, is voluminous. The recordkeeping and withholding a state requires can trigger for as little as a few moments of work in an-

other state. The research to determine any given state's individual requirement is expensive and time-consuming, especially for a small firm or small business that does not have a significant amount of resources. Taxpayers need to update the research, at least annually, to make sure the state law has not changed. Of course, a small firm or business may choose to engage outside assistance to research the laws of the other states; however, the business will incur an additional cost.

Many small firms and businesses use third-party payroll services rather than performing the function in-house. However, we understand that many third-party payroll service providers cannot handle multi-state reporting. For example, third-party payroll service providers generally report on a pay period basis (e.g., twice per month, bi-weekly) as opposed to a daily basis, which is necessary to properly report the performance of interstate work. Due to the software limitations, employers must track and manually adjust various employees' state income and withholding amounts to comply with different state requirements. The alternative is to pay for a more expensive payroll service.

CHALLENGES FOR EMPLOYEES

Employees face many challenges with complying with the multitude of state tax laws and requirements. When an employee travels for work to many states, even for short periods of time, each nonresident state tax return that is required is usually for a minimal amount of income and tax liability. Often, the employee is below the filing threshold, but since withholding is required, a nonresident state tax return is required, even if only to claim a refund of the taxes withheld.

UNIFORMITY AND DE MINIMIS EXCEPTION NEEDED

In addition to uniformity, there needs to be a *de minimis* exemption. AICPA has supported the 60-day limit contained in previous versions of similar legislation, but believes that the 30-day limit contained in H.R. 2315 is fair and workable. The 30-day limit in the bill ensures that the interstate work for which an exemption from withholding is granted does not become a means of avoiding tax or shifting income to a state with a lower tax rate. Instead, it ensures that the primary place(s) of business for an employee are where that employee pays state income taxes. For example, employees of many small businesses often travel to other states as part of their training, research, or operations. A prime example is a business located in South Carolina, which is on the border of North Carolina and Georgia, where no reciprocity agreements exist. It is easy for an employee to travel into three states within a few hours timeframe. For example: a small bike shop that has to occasionally cross state borders to buy a part, a catering company that delivers, and a roofing company that drives to the nearest home-improvement store (which is located across the state line).

CONCLUDING REMARKS

The current situation of having to withhold and file many state nonresident tax returns for just a few days of work in various states is too complicated for both employers and employees. The small business employers' costs to comply with the current system have become too burdensome and are not worth the lost economic productivity for those small businesses to justify the states in assessing and then trying to collect the tax. Employees are overwhelmed with the many states to which they may have a nonresident filing and tax obligation and the different filing criteria for each state. The AICPA urges Congress to pass H.R. 2315 to ease our country's nonresident state income tax withholding and compliance burdens. The bill provides national uniformity and a reasonable 30 day *de minimis* threshold. Therefore, the AICPA strongly supports H.R. 2315 and respectfully commends the co-sponsors of this legislation for the development of this reasonable and much needed bi-partisan bill.

The AICPA appreciates the opportunity to submit this written statement in support of H.R. 2315.

Statement of

Mel Schwarz

Partner,
Grant Thornton LLP

before the

House Committee on Small Business

Subcommittee on Economic Growth, Tax, and Capital Access

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Chairman Huelskamp, Ranking Member Chu, and Members of the Subcommittee,

I am grateful for the opportunity to speak to you today. Small business needs tax reform, and simplifying compliance and administration for small businesses should be part of that tax reform. This subcommittee's concern and interest in exploring the subject is to be applauded.

The complexity and costs of calculating many tax incentives makes it difficult for small businesses to properly take advantage of them. It is my firm's experience that because of this, many small businesses simply ignore them. This not only prevents these incentive provisions from accomplishing their intended purpose, but also results in small businesses being placed at a disadvantage compared to their larger competitors who are better positioned to incur the costs of calculation.

More importantly, it leads many small businesses to believe that they have been left out, that the incentives in the Code are intended to only be available to larger business, and that the system is simply not fair.

Grant Thornton urges Congress to pursue tax reform that would lower the tax rates applicable to all businesses, regardless of the form in which they conduct business. Small businesses are among the businesses most likely to organize as pass-throughs and it is essential that pass-throughs such as partnerships and S corporations be included in any reduction in tax rates.

We recognize the immense difficulty, however, in enacting fundamental tax reform. If for whatever reason such tax reform is not possible, or is only possible in the future, we believe that the ability of small businesses to share in the incentives provided by the Internal Revenue Code [1] could be increased by better focusing on those methods that are easier to compute and the use of safe harbors specific to small businesses that would simplify calculations.

I will focus the remainder of my testimony on the challenges faced by the small business community in taking advantage of two important Federal tax incentives, the research credit and the domestic production activities deduction.

Research Credits

The credit for increasing research is one of the most effective incentives in the Code. Studies have shown that additional research contributes a multiple of its cost in increased economic activity. Under current law, there are two methods are available for calculating the research credit: The traditional method and the alternative simplified method.

The traditional method provides a credit equal to 20 percent of the amount that current qualified research expenditures exceed a base amount that is determined by multiplying the business' aver-

[1] Unless otherwise indicated, all "section" references are to the Internal Revenue Code of 1986, as amended (the "Code" or "IRC"), and all "Treas. Reg. §" references are to the Treasury Regulations promulgated under the Code.

age annual gross receipts for the prior four years by a historical ratio of research expenses to average gross receipts that may be determined by years as early as 1984.[2] An alternative simplified method is available that provides a credit equal to 14 percent of the amount that qualified research expenditures for the current year exceed 50 percent of the qualified research expenditures for the preceding three years.[3]

It is my firm's experience that virtually no small- or medium-sized businesses uses the traditional method. In recent years, there have been numerous proposals to abandon the traditional calculation method and increase the credit percentage allowed for the alternative simplified method. Congress could provide a significant benefit to smaller taxpayers and enhance the use of the research credit by raising the alternative simplified rate. Regardless of the method chosen, the taxpayer is required to determine which of its expenditures satisfy detailed rules and regulations to be treated as qualified research expenses. Where the research is performed by the taxpayer, such expenses include wages paid to employees (or self-employment income of an owner) for engaging in qualified research or the direct supervision of qualified research, supplies (not including land, improvements to land, or property of a character subject to the allowance for depreciation), and amounts paid for the use of computers in the conduct of qualified research.

Small businesses would significantly benefit from the implementation of safe harbors that would simplify the process of determining which expenses qualify and the modification of existing safe harbors to facilitate their use by small businesses.

An example of an existing safe harbor that may serve larger taxpayers but does not fully satisfy the need of small businesses relates to the treatment of wages paid to employees with multiple responsibilities, only some of which are research related. The general rule applicable to such employees is that, in the absence of another method that the taxpayer can demonstrate to be more appropriate, the wages must be separated into qualified and nonqualified portions based on the number of hours worked on qualified and nonqualified activities.[4] Treasury regulations provide that an employee devoting 80 percent of his or her time to qualified research activities may be considered to have devoted all of his or her time to such activities.[5]

For large businesses with significant research staffs, it is generally possible to judge whether an employee spends substantially all of his or her time performing or directly supervising qualified research. In such cases, the 80 percent rule provides a cushion and may allow for the full inclusion of the employee's wages as qualified research expenses without further examination.

Small business employees, however, typically have a wider range of responsibilities than employees of larger organizations. Employees that are primarily employed for the purpose of doing research

[2] IRC § 41(a)
[3] IRC § 41(c)(5).
[4] Treas. Reg. § 1.41-2(d)(1).
[5] Treas. Reg. § 1.41-2(d)(2).

may also have a range of administrative and other duties that do not qualify as research under the Code and regulations. The likelihood that these other duties might exceed 20 percent requires smaller businesses to go through the process of examining time sheets or other records. Reducing the safe harbor percentage to 50 percent for small businesses would allow such businesses the type of cushion that would simplify their determination of which costs are qualified.

Domestic Production Activities Deduction

Subject to certain limitations, the domestic production activities deduction of section 199 provides a deduction equal to 9 percent (6 percent in the case of production of oil and gas) of the net profits from producing property (including software), providing certain utility services, or providing services i the areas of construction, architecture and engineering provided such property is produced or services provided in the United States.[6] Other types of service income, income from the resale of items not produced by the taxpayer, and most types of investment income, do not qualify. For corporations paying tax at a 35% marginal rate, the deduction is the equivalent of a 3 point reduction in the corporate tax rate.

Although relatively simple in concept, the domestic production activities deduction can be very difficult to determine in practice. In some instances, only a portion of the net income earned in an activity or even a single transaction may qualify for the deduction. Given the difficulty in determining the amount of eligible income, and the limited benefit to be derived from identifying that income, many small businesses have decided that the deduction is not worth the effort required to calculate it.

The Treasury has provided several safe harbors to assist taxpayers in the calculation of the domestic production activities deduction. One of these is the rule that allows all of a taxpayer's gross receipts to be treated as qualified if 95 percent of its gross receipts are qualified.[7] This allows taxpayers with only minimal amounts of nonqualified income to simply treat nine percent of their taxable income as their domestic production activities deduction.

However, taxpayers who are not comfortably within the 95 percent test must still go through the process of segregating their income into qualified and nonqualified portions, if only to determine whether or not they satisfy the 95 percent test. For those taxpayers, the 95 percent safe harbor may produce a small tax savings, but it does nothing to simply the calculation and make the benefit worth the effort required to obtain it.

The existing 95 percent safe harbor could be modified in several ways to make it more practical for small businesses, making it feasible for them to benefit from the provision in the same manner as their larger competitors. The percentage could be lowered, making it more likely that a small business could satisfy the safe harbor

[6] IRC Section 199
[7] Treas. Regs. § 1.199-1(d)(3).

and claim the benefit of the domestic production activities deduction without having to carefully segregate its income into qualified and nonqualified portions. Alternatively, the safe harbor could be modified to allow it to be applied solely to the active portion of a small businesses' income by first excluding identifiable investment income as nonqualified, and then applying the safe harbor to the remaining taxable income. While this might result in a reduced benefit in certain cases, it could significantly simplify the process of calculating the domestic production activities deduction, bringing its benefits within the reach of small as well as larger businesses.

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April 13, 2016

Statement of Robert Russell

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United States House Committee on Small Business, Subcommittee on Economic, Growth, Tax and Capital Access Hearing on "Keep it Simple: Small Business Tax Simplification and Reform, Main Street Speaks"

Mr. Chairman Huelskamp and Ranking Member Chu:

Thank you for inviting me to testify before the Subcommittee on Economic, Growth, Tax and Capital Access on this important topic of tax reform and simplification and making sure that small business does not get left behind in this discussion. I believe it is vitally important to remember that America's small businesses have needs, interests and resources that differ significantly from those of larger businesses and so it is essential that hearings such as this take place.

As background, the firm I am a part of, alliantgroup, is a leading tax service consultant for small and medium businesses across the country. alliantgroup has approximately 650 professionals located nationwide, focused on assisting small and medium sized businesses avail themselves of proper and available tax incentives, including tax credits, designed to create jobs, promote research and investment, and otherwise help the United States remain the leader in the global economy. We also assist these businesses in tax planning, and we represent them before the IRS and state tax regulators. In providing these services, we work with the CPA firms of these businesses.

We are uniquely positioned to speak to the issues you wish to discuss today because of our work with over three thousand CPA firms and tens of thousands of businesses from all over the country in a remarkably diverse set of industries. Daily interactions with our CPA partners and clients reveal that cross-border business is a reality for many of our nation's small and medium size businesses. I would specifically like to note a few of our CPA partners, James Guthrie, Jr. of Gallina, Dave Springsteen of Withum, and James Cordova of Windes for their valuable insights on these issues.

Specifically, in my time today, I will speak to the challenges facing small companies when they want to expand their businesses across borders and of the challenges their CPAs face in trying to assist them. Discussion both here and abroad occurs daily on re-

form of international tax systems, but much of that attention is focused on larger businesses rather than on the difficult challenges facing small businesses.

Mr. Chairman, if there is one takeaway from my message today, it is that although businesses of all sizes are now players in the global economy, our rules and regulations both in the U.S. and in foreign jurisdictions, have been built for big corporations. Our recommendation based on our experience is that a "one size fits all" approach cannot work and should be modified to provide needed adaptability and flexibility for smaller companies with resource constraints.

It is often cited that 95% of the world's consumers are outside of the US.[1] Therefore, it is too simple a view of the world to think that small businesses are not currently engaged in cross-border activities and are uninterested in growing further. Simply put, when considering international tax law modifications, small business needs and resources must be considered.

It is helpful to step back from time to time and focus on the larger economic picture. As colleagues that practice in the area of trade law like to quip "Tax is nothing but a speed bump on the superhighway of trade," or as you learn one day one of Tax Law 100 in law school, "the tax tail should not wag the business dog". Obviously, we are not advocating the elimination of taxes. However, far too often we see taxpayers shy away from expansion because of complexity and burden created by the tax code.

Today, I would like to focus on three areas that create barriers to business expansion, especially for small businesses: (1) Barriers created by information sharing concerns, (2) Barriers due to compliance costs that are needlessly and excessively burdensome, and (3) The need for real international tax reform both domestic and globally.

#1 Barriers Created by Information Sharing Concerns that Impact Simple Business Functions and Operations

It is surprising to many small businesses that expand overseas that there are incredible difficulties in establishing routine business operations. Many Americans would be shocked at activities we take for granted in this country that come with significant consequences when crossing borders. For example, something as basic as trying to open a bank account or create a banking relationship in another country as a US citizen. We have heard many stories of banks refusing to open accounts for US citizens due to the operation of the Foreign Account Tax Compliance Act (FACTA).

If you are able to jump through these hoops to establish financial accounts abroad, then a small business must navigate the overly-complex rules on how to properly report these accounts and assets to the US Government. This information must be reported on multiple forms to multiple agencies with varying amounts of informa-

[1] 95% of the World's Consumers Live Outside the United States, U.S. Chamber of Commerce. (May 15, 2012) available at https://www.uschamber.com/ad/95-worlds-consumers-live-outside-united-states

tion to be disclosed. The requirements are not consistent in many areas such as reporting to FINCEN versus the IRS. This is increasingly perilous as a failure to properly comply comes with enormous risk. Rules that were crafted to hammer those with hidden bank accounts in Switzerland or Panama leave legitimate businesses in an expensive and risky place—even when they have a history of paying proper amounts of tax and are trying to be compliant. The possible penalties are draconian and can fairly be stated to shock the conscience. The penalty structure for failure to report these accounts could penalize the taxpayer 100% of the amount in the account even if there is little or no income tax due. A fresh look at the policies, penalties and reporting requirements from a law-making perspective is overdue.

United States procedural requirements also have real world impact on foreign businesses wanting to work with US taxpayers. Experience in working with our clients and CPAs has uncovered situations where, for example, foreign joint ventures have been rejected where the foreign company admitted to using a lesser quality competitor because they did not want to deal with the US reporting requirements that came along with the US partner.

We also have clients who express frustration at losing business with foreign partners due to required over-withholding of taxes simply by administrative burdens. This is the effect of the extreme difficulty that foreign parties doing business with US partners have in obtaining US tax identification numbers. While intended to prevent abuse, the practical effect is excess tax withholding on a transaction with no practical remedy. In reality, these transactions should be granted the benefits of a tax treaty that was put in place specifically to facilitate trade in this manner. Many times the difference between the proper amount of tax withholding from a transaction compared to the over-withholding by reason of administrative difficulties is enough to kill many business deals for US businesses.

#2 Barriers Created by Complexities of International Expansion and Compliance Costs

Mr. Chairman, too many times when changes are considered to our tax system, whether in changing the law or in issuing guidance by the Treasury Department, the costs to the taxpayer in time and professional fees are not adequately considered. As could be expected, studies have shown that compliance costs skyrocket when dealing with overseas activities.[2] While there are a multitude of examples we see frequently, we would like to highlight two areas in the cross-border context where the compliance burden, and risk for non-compliance, for small business should be addressed.

The first area can be shown by a real example. In this case, there is a small specialized equipment manufacturer looking to expand business overseas. They set up a foreign affiliate in the new coun-

[2] See Dharmapala, Dhammika and Slemrod, Joel B. and Wilson, John D., Tax Policy and the Missing Middle: Optimal Tax Remittance with Firm-Level Administrative Costs (May 5, 2008), and Slemrod, Joel. "The Compliance Cost of Taxing Business." Mimeo. University of Michigan. (2006).

try to distribute and sell equipment locally. For this one enterprise with a seemingly simple setup comes an almost debilitating compliance cost and/or risk. In this operation there may be inter-company payments for equipment purchased or services provided between the related entities. There also may be distribution and service/warranty agreements. Under highly complex transfer pricing rules, these transactions must be analyzed in comparison to the outside marketplace, and the mandatory documentation requirements are simply not adapted for small businesses. Furthermore, the rules provide for penalty protection against IRS audit if proper analysis is completed to support the taxpayer position. Small taxpayers and their CPAs are concerned. Transfer pricing is one of the most audited issues by the IRS and billion dollar audit adjustments with penalties do not only make the tax press but also the mainstream media. Honest taxpayers looking to be compliant with the by-the-book documentation requirements and penalty protection must decide whether to engage economists, lawyers and accountants at significant costs because of the required analysis.

Currently, there is no saving grace for small business. There are no de minimis exceptions for low-risk transactions where little abuse occurs, and there are no flexible documentation applications for smaller transactions and smaller businesses. Examples do exist in other countries where small and medium size businesses are subject to simpler rules based on items such as employee number, turnover or assets. alliantgroup has met with the IRS and the Treasury Department in the past in an effort to create Transfer Pricing guidelines that will prevent abuse but not drive smaller companies out of cross-border business. This idea of a transfer pricing "lite" would be a huge step forward for those companies with limited resources but that want to be compliant with transfer pricing rules.

We note that during the OECD's recent Base Erosion and Profit Shifting (BEPS) project, consideration was given to how developing countries could interpret transfer pricing guidelines. It was recognized that throwing thousands of pages of rules at them and asking the tax administrations with limited resources to enforce these convoluted rules was untenable. There is no reason why a similar look should not be taken regarding the transfer pricing rules with respect to smaller businesses here in the US.

Another example where compliance costs are not commensurate with the value to the government arises in the area of Passive Foreign Investment Companies (PFICs). While the policy principles behind these rules addressing this specific foreign activity is sound, quite simply, the reporting requirements are not applied to the appropriate group of taxpayers. When businesses operating overseas make investments or arrange capital, many times they are swept into the incredibly complex web of PFIC reporting. There are no consolidation or streamlined filing provisions or de minimis exceptions. We have received numerous reports from CPAs and have worked with clients regarding the hyper-technical and excessing filing requirements for PFIC situations. Even worse, many of these separate forms reported very minor amounts of income and tax owed. This is combined with significant penalties for misreporting

PFIC investments. There is a legitimate question as to whether the PFIC reporting rules serve a useful purpose in our tax system. There is no question, however, that as designed they are overbroad and excessive.

This moves to the next point, everyone recognizes the IRS is stretched thin. Speaking to our CPAs and our clients, they are looking for more help from the IRS, including more guidance; more educational outreach; and additional trained people with whom to talk. Our clients and their CPAs are also concerned the IRS systems be secure.

#3 There is a Need for Reform in Both the US and the Global Tax Environment

It is, at this point, a truism that the US international tax system is broken and in need of reform. While we will not go into what reform should look like in this forum, we urge Congress to reform the law and before doing so, consider how that reform will impact small and mid-size businesses. A one-size fits all rule generally makes little sense. This leads to the simplicity part of this hearing. Simplicity is a pillar of tax policy that is many times overlooked. For complex transactions, sometimes complex rules may be necessary, however, in our experience, many rules are written assuming that well-heeled companies will be able to comply, and that there is rampant abuse that must be guarded against. Neither assumption is correct in all cases. We urge that the following questions be asked in each case: (A) is the rule too complicated for smaller taxpayers to understand and comply with; (B) What are the compliance costs associated with the change; and (C) Is it impossible for tax administration to enforce?

We have discussed problems in our current system. We would also note that our system encourages businesses to keep their foreign profits overseas and not to repatriate them to the US for US jobs and investment—commonly referred to as the "lockout effect". This is something that big corporations can live with because of the size and scope of their global activities, but it is an enormous challenge for small business where every dollar of profit is needed to grow and reinvest. This highlights the need to lower the tax rates to be competitive globally is even more pressing for small business. We all hear stories of large multi-national companies being able to lower their effective tax rates to significantly less than the headline rate. Small business, especially in the early stages of expansion, do not have the resources to engage in sophisticated tax planning and need for their cash back home subjecting them to a high effective tax rate that very few other multi-national businesses ever experience.

To this end, Congress should consider additional incentives for small and mid-side business attempting to expand overseas. One existing example is the highly valuable Interest Charge Domestic International Sales Corporation or IC-DISC. This is the last existing export incentive and is a great help for businesses selling domestic goods and services overseas.

Finally, Mr. Chairman, I would like to place the importance of US reform in the context of the global tax environment. In 2014, the OECD initiated the Base Erosion and Profit Shifting Project (BEPS) where tax policy makers and administrations came together.[3] In 2015, the OECD issued final recommendations for tax policy changes on 15 so-called "Action Items".[4] It can be argued that much of BEPS is the result of countries around the globe seeing a pot of US deferred gold. Many of the proposed rules pose cause for concern and may create yet more barriers to small business entering or continuing cross-border business.

While other countries are swiftly implementing these BEPS measures, I commend Congress and Treasury6 for taking a slower path. While a discussion of each BEPS Action item is beyond this hearing, we do want to highlight one example of our concern: country-by-country reporting.

Country by country reporting brings two concerns for companies. First, is the added compliance burden (and costs) for businesses to report additional company data. It should go without saying, every dollar spent on compliance cost contributes to less jobs on the assembly line. Second, there are real data security and confidentiality concerns. We support Treasury and Congress for holding the line on exchanging information only through treaties and confidentiality rules being protected against the wishes of many others. We want to acknowledge the importance of taking action when information is not protected by other countries. It is important to note, while there is currently a threshold for company size on this reporting, history has shown time and again, limits of this type are lowered or eliminated to engulf many businesses.

Conclusion

Thank you Mr. Chairman Huelskamp and Ranking Member Chu for allowing me to testify today on this important topic of tax reform and simplification for small business. Far too often, small and mid-size business concerns take a back seat in the tax reform discussion and even more so in the international context. I hope today I was able to highlight some real issues facing our nation's smaller business taxpayers when conducting cross-border business.

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[3] OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing. http://dx.doi.org/10.1787/97892642027190en

[4] OECD (2015), Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project, OECD. www.oecd.org/tax/beps-explanatory-statement-2015.pdf

Written Testimony of Julie Verratti

Director of Business Development and Founder of Denizens Brewing Company

House Small Business Committee

Subcommittee on Economic Growth, Tax and Capital Access

April 13, 2016

Chairman Huelskamp, Ranking Member Chu and members of the Subcommittee, thank you for the opportunity to testify at today's hearing. My name is Julie Verratti. I am the Director of Business Development and co-founder of Denizens Brewing Company in Silver Spring, Maryland. I am speaking on behalf of my small business and the Brewers Association, which represents more than 3,000 craft brewers, 46,000 members of the American Homebrewers Association and 1,100 industry suppliers of agricultural commodities, brewing equipment, packaging, and other goods and services required by modern breweries. I appreciate the opportunity to testify today.

My co-founders Emily Bruno, Jeff Ramirez, and I started Denizens in 2014. Denizens is the only woman and minority owned and operated brewery in Maryland and a proud member of the Silver Spring community. We are both a restaurant and a production brewery. We produce beer to be sold in our restaurant and throughout Maryland and Washington, D.C. In the short time that we have been open, our brewery has experienced solid growth. In 2015, we produced 1,140 barrels and are on track to produce 1,500 barrels in this coming year.

Running a craft brewery like Denizens is similar to running any other small business. All of the day-to-day activities and stresses like scheduling, marketing, healthcare and payroll are amplified by a tight brewing schedule and working to distinguish ourselves in a growing industry. Denizens has close to 40 full-time employees who range from tipped service positions, kitchen staff, brewing staff (manufacturing jobs), and salaried professional positions. All of our full-time employees who work 30 or more hours a week, whether they are hourly or salaried, are offered medical, dental, and vision insurance through the company.

As the director of business development for the brewery it is my responsibility to conduct outside sales, liaise with the state and local chamber and brewery guilds and handle all the licensing and tax issues that arise. Denizens produces beer in Maryland and we sell our beer in Maryland and the District of Columbia. Our tax and compliance burdens are significant as we must collect and submit sales tax in our taproom, pay employment taxes, business income taxes, and excise taxes to both the state and federal governments using their separate and individual filing systems. I spend up to 5 hours a month working on taxes, which may not seem like a lot of time but is significant when you are working to grow your business. In the next month my brewery will start distributing in

Virginia, which will increase the number of tax regulations that we must comply with. Any way that the government could help to streamline and decrease this burden would be extremely beneficial to craft breweries like mine and smaller breweries that want to grow but don't have the manpower and funds to do so.

The Brewers Association defines a craft brewery as any brewery that is "small," with an annual production of 6 million barrels of beer or less (the 6 million threshold is approximately 3 percent of U.S. beer sales, but the vast majority of craft breweries are closer in size to mine in the 1,000-10,000 range); "independent," less than 25 percent of the craft brewery is owned or controlled (or equivalent economic interest) by an alcoholic beverage industry member that is not itself a craft brewer; and "traditional," a brewery that has a majority of its total beverage alcohol volume in beers whose flavor derives from traditional or innovative brewing ingredients and their fermentation.

There are more than 4,000 craft breweries in the United States. To provide some perspective, Denizens brews less than 2,000 barrels a year. Yet we are larger than 70 percent of the craft breweries in the country. I am lucky that I have the tools, knowledge and support to navigate the complex tax codes. A craft brewery that does not have a similar infrastructure is going to find the same tasks much more difficult. Currently breweries are required to comply with different federal and state excise taxes and alcohol regulation agencies. The Alcohol and Tax and Trade Bureau (TTB), the IRS and the Maryland Comptroller. Oftentimes, there are different requirements about when and what to file. Denizens is required to file different taxes bi-weekly, monthly and quarterly with both the federal government and the state of Maryland, although we have received some relief from the federal requirement that I will discuss below.

In many cases we have found that even if there is a way to file online, it is easier to file the forms in hard copy. I tend to do the work for my filings online and then print them out to mail them in. It would be significantly more convenient if the federal and statement governments worked together to come up with a more streamlined process for reporting. A large portion of my time spent on taxes is duplicating information from one report to another. As Denizens continues to grow, which we plan on doing, we will likely expand sales and distribution to other states. To do so means that we will nee4d to file excise taxes or sales reports to comply with each state's alcohol beverage laws. We are happy to comply, but these tax burdens could be a deterrent for a smaller brewer. There are breweries like mine that have the demand for their product and the desire to grow but don't have the personnel or capital to do so.

The federal government has taken the steps to correct some of the burdensome biweekly excise tax filing requirements. Last year, language was included in the year-end tax extenders package that made it so any alcohol producer that pays less than $50,000 in annual federal excise taxes will no longer be required to get a bond and will only need to file quarterly. The cost savings is small, but

substantial time will be saved by businesses and the TTB as thousands of biweekly returns will be eliminated. This is a perfect example of businesses working with Congress and the Treasury Department and the Alcohol and Tobacco Tax and Trade Bureau to come up with a solution that is beneficial to both parties. I hope that we will be able to accomplish other process improvements to facilitate the growth of the craft brewing industry and to improve the efficiency of routine federal approvals and the excise tax collection process.

With 4,269 breweries in the United States and more opening at a rate of 1.9 per day the craft brewing industry is the largest it has ever been in this country and it is continuing to grow. Craft brewing now represents 12% of the US beer market by volume and 21% in final retail dollar sales. There is still room for growth, something we would like to work with Congress to accomplish.

U.S. Brewery Count

	2012	2013	2014	2015	'14 to '15 % Change
CRAFT	2,401	2,863	3,576	4225	+ 18.1
Regional Craft Breweries	97	119	135	178	+ 31.9
Microbreweries	1,149	1,464	1,971	2,397	+ 21.6
Brewpubs	1,155	1,280	1,470	1,650	+ 12.2
LARGE NON-CRAFT	23	23	26	30	
OTHER NON-CRAFT	32	31	20	14	
Total U.S. Breweries	2,456	2,917	3,622	4,269	+ 17.9

As I mentioned previously, breweries like mine pay excise taxes on both the state and federal level. They are additional taxes over and above our business and payroll taxes, and excise taxes are one of the major expenses that I, as a brewery owner, face. In 1976 Congress wanted to help encourage the growth of American craft brewing. The Internal Revenue Code was changed to stipulate a demarcation point for any domestic brewer that produces less than 2 million barrels of beer a year. Brewers below that threshold pay $7 per barrel in federal excise taxes on the first 60,000 barrels and $18 per barrel on anything over that. When the federal beer excise tax was first put into place to finance the Civil War, excise taxes were a major source of revenue and most other modern federal taxes did not exist. Today, brewers pay all of the same individual and corporate taxes paid by all businesses as well as payroll taxes on behalf of our employees. Brewers also pay excise taxes to their states and in some cases to local governments.

For almost a decade the Brewers Association has been working with Congress to try and pass legislation that recalibrates the federal excise tax to reflect the makeup of the craft brewing industry, and to spur additional growth. In the 114th Congress, this legislation is the Craft Beverage Modernization and Tax Reform Act (S. 1562/H.R. 2903). The Senate version was introduced by Senators Wyden (D-OR) and Blunt (R-MO), and the House version was introduced by Representatives Paulsen (R-MN) and Kind (D-WI). This legislation would lower the federal excise tax for the brewing industry as well as the wine and distilled spirits industries, and

make the alcohol beverage excise tax system more progressive for smaller producers and it has broad industry support.

For craft brewers, in particular, this bill would reform the federal excise tax structure on beer by:

- Reducing the federal excise tax to $3.50 per barrel on the first 60,000 barrels for domestic brewers producing fewer than 2 million barrels annually and reducing the amount brewers pay from 60,001-2 million to $16 per barrel.
- Reducing the federal excise tax to $16 per barrel on the first 6 million barrels for all other brewers and all beer importers.

It is legislation like this that would have a major impact on my business, as well as other craft brewers. Denizens is a growing brewery and if we continue at our current trajectory, we will be at capacity within the span of a year. Legislation like the Craft Beverage Modernization and Tax Reform Act would benefit us greatly. If we are able to get our federal tax liability reduced we will be able to purchase more equipment and kegs to produce more beer and hire at least two additional new employees.

Knowing that we would have access to additional capital is an incentive to continue growing and hiring, which will produce more federal revenue over time. Whether it is additional payroll taxes for newly hired workers, or expanding production to enter a new state market, a reduced federal excise tax liability would be extremely helpful to the craft brewing industry and the national economy. In fact, economists predict that just the beer portion of the bill would create an additional 9,000 jobs in the first 12-18 months after it is implemented and an additional $320 million in economic growth. The Craft Beverage Modernization and Tax Reform Act would be good for the country and help to ensure that brewers can continue to compete with larger brewers and foreign competitors.

It is no surprise that this bill has widespread support from not just the Brewers Association and the Beer Institute, but also groups like the Wine Institute, Wine America, DISCUS, the American Craft Spirits Association, the National Barely Growers, the Can Manufacturers Institute and more. The legislation will have a widespread impact on a range of different industries from agriculture to retail. Every dollar saved in relief mean nearly $8 of growth for the U.S. Economy. The bill also updates tax administration.

With craft producers in every state and Congressional District across the country strong bipartisan support exists for the Craft Beverage Modernization and Tax Reform Act. The legislation has 172 co-sponsors in the House and 33 in the Senate (as of 4/11/2016). There is broad bipartisan support to help encourage the growth of the craft brewing industry and continue to create good manufacturing and service industry jobs across our country.

In conclusion, taxes, and tax compliance costs, are the largest expenses that craft brewers like Denizens deal with on a day-to-day basis. We are more than happy to pay our fair share, but a recalibration of the federal excise tax would have an extremely posi-

tive impact on small brewing businesses like mine and the ones in your home states.

Thank you again, I appreciate the subcommittee inviting me to testify today on behalf of the Brewers Association and craft brewers across the country.

Statement of Henry C. "Hank" Johnson, Jr. for Hearing on "Keep It Simple: Small Business Tax Simplification and Reform, Main Street Speaks

April 13, 2016

H.R. 2315, the Mobile Workforce State Income Tax Simplification Act of 2015, is an important, bipartisan bill that will help workers across the country. It will also help small and multistate businesses.

As a proud sponsor of this legislation in both the 110th and 111th Congresses, I am very familiar with this issue. I welcome my colleague Congressman Bishop's leadership on this bill in the 114th Congress. With 134 cosponsors this Congress, it's clear that Mobile Workforce is an idea whose time has come.

H.R. 2315 would provide for a uniform and easily administrable law that will simplify the patchwork of existing inconsistent and confusing state rules. It would also reduce administrative costs to the state and lessen compliance burdens on consumers.

For example, AcuityBrands is a leading lighting manufactures that employs over 1,000 associates in my home-state of Georgia and has over 3,200 associates nationwide who travel extensively across the country for training, conferences, and other business. In a letter in support of H.R. 2315, Richard Reece, Acuity's Executive Vice President, writes that current state laws are numerous, varied, and often changing, requiring that the company expend significant resources merely interpreting and satisfying states' requirements. He concludes that "[u]nified, clear rules and definitions for nonresident reporting and withholding obligations would undoubtedly improve compliance rates and it would strike the correct balance between state and sovereignty and ensuring that America's modern mobile workforce is not unduly encumbered."

We should heed the calls of Acuity and numerous other businesses across the country by enacting H.R. 2315 into law. In closing, I thank Chairman Chabot for calling today's hearing, and I urge my colleagues to support this bill so that it can come to the floor for a vote soon. This country's employees and businesses deserve quick action.

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