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EXPANDING OPPORTUNITIES FOR SMALL BUSINESSES THROUGH THE TAX CODE

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE

ONE HUNDRED FIFTEENTH CONGRESS

SECOND SESSION

OCTOBER 3, 2018

Printed for the Committee on Small Business and Entrepreneurship



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EXPANDING OPPORTUNITIES FOR SMALL BUSINESSES THROUGH THE TAX CODE

WEDNESDAY, OCTOBER 3, 2018

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

The Committee met, pursuant to notice, at 2:37 p.m., in Room 428A, Russell Senate Office Building, Hon. Marco Rubio, presiding.

Present: Senators Risch, Rubio, Ernst, Inhofe, Young, Enzi, Kennedy, Cardin, Cantwell, Shaheen, Heitkamp, Markey, Booker, Hirono, and Duckworth.

OPENING STATEMENT OF HON. MARCO RUBIO, A U.S. SENATOR FROM FLORIDA

Senator RUBIO. The hearing will come to order.

Today's hearing of the Senate Committee on Small Business and Entrepreneurship is about a topic that is quite important, and it is timely as the full measure of last year's Tax Cuts and Jobs Act continues to set in midst various other competitiveness policies, such as confronting China on unfair economic practices.

In our new global economy, it is not enough to just cut taxes. You have to also cut the right ones, and the new tax law passed late last year included a provision called Economic Opportunity Zones. This law, which was championed by my good friend Senator Tim Scott of South Carolina, will encourage investment in economically distressed communities by allowing investors to defer certain taxes on income if they invest in low-income communities.

The new global economy has increased the wealth of many Americans, but it has destabilized entire regions in our country and left millions of workers behind.

Pushing investment to seek out the largest return, regardless of which nation or area within the nation, has led to the desertion of workers in our own back yards.

Parts of Florida have experienced this firsthand. The disparities are a testament to the uneven prosperity of globally driven rapid growth.

This is where Economic Opportunity Zones comes in. While investors in a global economy might seek a better bottom line by shipping jobs to a foreign country, this provision cuts taxes on the investments that make jobs here in America.

The global economy is marked by pushing investment to maximize short-term gain, but Economic Opportunity Zones reduce that

short-sighted incentive by cutting taxes on investments held for at least 10 years in what are currently lower-income areas.

This tax provision is not for outside businessmen to make a quick buck in low-income areas. This provision encourages long-term gain for the community.

Small businesses like the ones discussed here today are not just competing in their own local economies. They are competing in many industries against the world.

This is not a relaxed environment. Day in and day out, small businesses seek out a competitive edge through hard work, creativity, and innovation.

If a small business has a great breakthrough, it does not stay small for long. America's greatest competitive advantage has always been the ingenuity of our people. Tax cuts should play to that strength.

And as Congress looks to make some of the provisions of last year's tax law permanent, we should put full expensing near the top of that list. Full expensing allows businesses to immediately deduct their capital investments instead of eating their cost over a decade at a time.

This means more money to spend on better products, facilities, and new shops. It removes a barrier to small business owners putting their ideas into action, making it easier to pull designs off blueprints and onto shop floor.

Unlike other tax cuts, which cut tax rates without regard for investment plans or the creation of American jobs, full expensing rewards the future economy, not the one of the past. It is the tax cut for the American idea.

The tax law's full expensing provisions for the next 5 years is the greatest thing we can do to remake American high-wage jobs for the 21st century. I hope we make it permanent.

With that, I recognize the Ranking Member to offer his opening statement.

OPENING STATEMENT OF HON. BENJAMIN L. CARDIN, RANKING MEMBER, A U.S. SENATOR FROM MARYLAND

Senator CARDIN. Well, thank you, Senator Rubio, and thank you, Senator Risch, for calling this hearing, an incredibly important subject, expanding opportunities for small business through the Tax Code. I can tell you this is an issue I hear frequently from small businesses as to how the Tax Code challenges them dealing with running a business. So I very much appreciate this subject. I think it is extremely important that this Committee hold this hearing.

I want to thank all of our witnesses. Ms. Bruckner, I want to also acknowledge you are familiar with our Committee, as I understand.

Ms. BRUCKNER. Yes.

Senator CARDIN. Your students are here watching you today, so it is good to have your students in the room, and I welcome them also to today's hearing.

Because of the impact that the Tax Code has on small businesses, I was and still am disappointed about the rush partisan process that ultimately resulted in last year's Republican tax bill.

As I said before, the rushed and opaque process prevented our constituents from weighing in in a meaningful way on the policies that will affect all of them.

It also resulted in a bill that the Joint Committee on Taxation estimated would add $1.4 trillion to the deficit, which could put important programs such as Social Security, Medicare, and Medicaid at risk for severe cuts in the future. This deficit is unconscionable, and as we are starting to see projections on the deficit come in now, those projections are accurate. And that is terribly unfortunate, and it is a burden we are all going to have to figure out how to deal with, which will have an impact on our small business community.

One of the biggest concerns I have with last year's tax bill is that it does not sufficiently target its benefits towards middle-class taxpayers. I include in middle-class taxpayers, the entrepreneurs and small businesses that are growing our economy.

The purpose of the tax bill from the beginning was to help reduce the C rate because of its international competition factors. I understand that. That was the purpose of the bill, and those are the entities that got the lion's share of the tax relief on a permanent basis.

Some of these businesses, small businesses, will see their tax bills reduced, while others will actually see tax bill increases. Regardless of the benefits to each taxpayer, I believe the tax bill was a missed opportunity for targeting the Code to small businesses as well as modernizing the Code to address the challenges these businesses face.

For instance, data on business size and revenues suggest that very small businesses will only receive a tiny portion of the revisions that are billed as small business provisions in the tax bill. Based on available data, this misallocation seems especially true for small women- and minority-owned businesses.

This is a big issue for Maryland. According to a survey conducted earlier this year by Paychex, Maryland has the highest rate of per capita minority- and women-owned businesses in the United States.

As you know, Mr. Chairman, I held a field hearing last month at Morgan State University to discuss the challenges minority-owned businesses face with respect to accessing capital. Taxation is an important piece of this puzzle. A major source of capital for expansion of a business is reinvesting profits, and the amount of tax a business must pay determines the amount of money available for growth.

However, it appears that the tax benefits of the provisions most touted as a small business provision, the new Section 199A pass-through deduction, skews heavily towards wealthy, established, non-minority-owned businesses. And as I pointed out, the provisions are not permanent.

In addition, I have heard from businesses of all sizes in the amount of complexity the bill adds. It adds complexity because it is not a permanent provision. It adds complexity because of the way that the calculations need to be made for eligible income.

Both tax practitioners and small businesses in Maryland organized as pass-throughs have come to my office with questions and concerns about how to claim and accurately compute the Section

199A pass-through deductions. These questions continue, even following the guidance that the IRS released in August.

It is my hope that this Committee will serve an important role in evaluating, correcting these and other issues. We must help Congress develop more efficient tax policies that are truly designed to provide a leg up to small business.

It is my hope that this hearing will serve as an opportunity to develop an agenda for this Committee going forward on tax policy.

The deeply partisan exercise that was undertaken last year is against the best traditions of this Committee, which is broadly known for its bipartisanship. It is the role of our Committee to advocate on behalf of small businesses. We have done that consistently on a nonpartisan, bipartisan basis. We recognize small businesses are the growth engine of our economy. That is where jobs are created and innovation takes place, and we need to work together in order to make the proper recommendations in regards to how the Tax Code affects small businesses in our community.

I look forward to all the witnesses' testimony, and I look forward to working with my colleagues on both sides of the aisle in order to make concrete recommendations on tax issues for small business.

Senator RUBIO. Thank you.

I want to recognize Senator Kennedy to present our first witness, and we have a distinguished panel. We will get to the others in a moment.

Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman.

We do have a distinguished panel today, and it is my pleasure to introduce to the Committee, Dr. Christel Slaughter. She is here today representing the U.S. Chamber Small Business Council. Dr. Slaughter is the CEO of SSA Consultants. That is a well-known entity in Louisiana. It is a woman-owned management consulting and organizational development firm, which she joined in the early 1980s. Dr. Slaughter's expertise is in organizational design and development, specializing in areas such as strategic planning and performance improvement.

To give you an example of some of her recent work, it includes leading an ongoing organizational development design and build-out of something very important in my State, the Louisiana Emergency Response Network, and also designing integration strategies for the State of Louisiana's multibillion-dollar coastal protection and restoration efforts, also something of paramount importance to Louisiana.

Dr. Slaughter serves on the board of the U.S. Chamber of Commerce. She is the chair of the U.S. Chamber Small Business Council. She became the very first woman chairman of the Baton Rouge Chamber of Commerce way back in 1986. She serves on the State Chamber board of directors as well as the executive committee.

She holds a bachelor's degree in marketing. Her doctorate is in systems management and organizational design. Both of them are from the Louisiana State University, and I am looking forward to hearing Dr. Slaughter's testimony today, as I am looking forward to hearing the testimony of all of our witnesses.

Welcome, Doc.

Senator RUBIO. Thank you, Senator Kennedy.

In addition, we want to welcome Mr. Lettieri. Lettieri is the co-founder and president of the Economic Innovation Group. In this role, he leads their policy development, economic research, and legislative affairs efforts to study and address regional inequality across the United States.

He has worked with members of this Committee on a policy provision that we have discussed, the Opportunity Zones, was included and passed in the Tax Cuts and Jobs Act.

Mr. Arensmeyer is the founder and CEO of Small Business Majority. He has started numerous businesses and held leadership roles in which he worked on issues of importance to small businesses ranging from health care to access to capital to taxes.

Ms. Caroline Bruckner is the managing director of—is it Kogod?

Ms. BRUCKNER. Kogod.

Senator RUBIO. Kogod Tax Policy Center at American University. Prior to this role, she served as a tax counsel in the Senate, where she worked on both this Committee and the Senate Energy Committee. Ms. Bruckner focuses her research on tax issues specific to small businesses and entrepreneurs.

And we will begin with Dr. Slaughter. Thank you, you are recognized for your opening comment.

STATEMENT OF CHRISTEL SLAUGHTER, Ph.D., CHAIR, U.S. CHAMBER SMALL BUSINESS COUNCIL, BATON ROUGE, LA

Ms. SLAUGHTER. Thank you, Senator Rubio. Thank you, distinguished members of the Committee. I am very honored to be here on behalf of the Small Business Council. My name is Christel Slaughter, as you heard. I am the CEO of SSA Consultants, based in Baton Rouge, Louisiana, and the chair of the U.S. Chamber of Commerce's Small Business Council.

The Chamber is the world's largest business federation. It represents the interests of over 3 million businesses of all sizes, sectors, and regions, as well as State and local chambers and industry associations.

Ninety-six percent of Chamber member companies have fewer than 100 employees, and 75 percent have fewer than 10 employees. The Small Business Council works to ensure that the views of small business are considered as part of the Chamber's policy-making process.

I am here today to give you a few examples of positive impacts from tax cuts. The U.S. Chamber of Commerce produces a quarterly small business index in partnership with MetLife, and the most recent survey shows small business confidence at an all-time high. The findings of our quarterly survey show a great deal of confidence in the direction of the national economy and shows that 69.7, almost 70 percent of small business owners have a positive outlook about their company and the small business environment in the United States.

Early this year and for the purposes of this hearing, small business owners were surveyed, and they were twice as likely to think that tax reform would help their business rather than those who thought that it would hurt.

At a meeting earlier this year, several of my fellow Small Business Council members discussed their plans to reinvest savings realized from the Tax Cuts and Jobs Act.

Melissa Bercier, who is the founder of Couch Clarity, which is a private psychotherapy practice near Chicago, explained how tax cuts are giving her an opportunity to provide team building and professional development for her staff of 10. Melissa calls her reinvestment strategy, "helping the helper." The strategy has a positive domino effect because Couch Clarity's two locations help people in the community, and a happy Couch Clarity staff means a happy community.

David Mahoney is the president and CEO of Noble Gas Solutions in Albany, New York, a gas distribution and welding supply company with 33 full-time and 3 part-time employees. David explained how difficult it was getting through the Recession, with Noble Gas Solutions experiencing a 15 percent decline in revenue and an 8-year business drought without experiencing any additional sales in Upstate New York. He told me that last year, the economy in the Northeast finally seemed to rebound, and his sales came up 10 percent. The tax cuts allowed David to raise wages and prompted him to plan for hiring new staff, a luxury he could not afford for the past several years.

Melissa is here in Washington, D.C., this week to join several hundred other small businesses for the U.S. Chamber of Commerce's fourth annual Small Business Summit. Many of us were here on Capitol Hill yesterday meeting with our Senators to help explain how we are putting tax reform savings to work by reinvesting in our employees, our businesses, and our communities. These examples of how we are reinvesting tax cut savings to provide higher salaries and increased benefits for our employees are echoed by small businesses throughout the United States.

In my small business, our employees are taking home more of their earnings, and many of our clients are benefiting from the Tax Cuts and Jobs Act.

One of those clients, Roy O. Martin, announced the opening of a new state-of-the-art Oriented Strand Board, or OSB plant, in Corrigan Texas, this past year. At full capacity, the plant will ship enough product to provide OSB for approximately 70,000 U.S. homes per year. Roy O. Martin's investment in the new plant created 165 direct jobs and more than 470 indirect jobs in construction.

Another example from one of our clients is ExxonMobil, who announced that it is reinvesting $50 billion in U.S. operations because of tax cuts. That was music to the ears of my client, which are the locations of ExxonMobil in Baton Rouge. These locations employ more than 6,500 people in our State.

As a practical matter, my job as an organizational consultant is less difficult when employees are taking home more pay and the company they work for is committed to reinvestment and growth. The tax cuts will allow them to make additional investments in operation and staffing.

This example shows the positive ripple effect of business confidence and optimism due in part to tax reform.

Our organizational consulting firm has seen an increase in business this year. Our clients are doing well. They want to remain competitive by working with us on strategic plans and making sure that they retain their talented employees in this increasingly tight labor market.

We do see some improvements that would be needed for tax reform to have an even greater positive impact, and finally, we would like to work with the Committee and your colleagues on the Finance Committee to make the small business tax cuts permanent.

Many of us want to plan ahead, whether it is to grow our businesses, sell our businesses, or pass on what we have to our children or employees. The expiration of several tax benefits in 2025 will limit our ability to implement expansion or transition plans for our businesses.

We look forward to working with you on ways to improve the Tax Code through legislative action, and we appreciate your attention to the ongoing benefits of the Tax Cuts and Jobs Act for the small business community by holding this hearing.

Thank you so much.

[The prepared statement of Ms. Slaughter follows:]



Statement of the U.S. Chamber of Commerce

Expanding Opportunities for Small Businesses Through the Tax Code

Christel Slaughter, Ph.D.

Chair, Small Business Council

Committee on Small Business & Entrepreneurship
United States Senate

October 3, 2018

The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96 percent of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

The Chamber represents a cross-section of the American business community with small and large businesses, across major classifications of American business—including manufacturing, retailing, services, construction, wholesalers, and finance. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

My name is Christel Slaughter, Ph.D. and I am the CEO of SSA Consultants based in Baton Rouge, Louisiana and the Chair of the U.S. Chamber of Commerce's Small Business Council. 96 percent of Chamber member companies have fewer than 100 employees and 75 percent have fewer than 10. The Small Business Council represents small business voices as part of the Chamber's policy-making process.

Examples of Positive Impact from Tax Cuts:

The Chamber publishes a quarterly small business index in partnership with MetLife. The most recent survey shows small business confidence at an all-time high.[1] The findings reflect a confidence in the direction of the national economy and show that 69.7 percent of small business owners have a positive outlook about their company and the small business environment in the United States. Small business owners surveyed earlier this year were twice as likely to think tax reform would help their business rather than hurt it.[2]

At a meeting earlier this year, several of my fellow Small Business Council members discussed their plans to reinvest savings realized from the Tax Cuts and Jobs Act:

> Melissa Bercier, founder of Couch Clarity, a private psychotherapy practice near Chicago, explained how tax cuts are giving her an opportunity to provide team building and professional development for her 10 staff. Melissa calls her reinvestment strategy, "helping the helper." The strategy has a positive domino effect because Couch Clarity's two locations help people in the community, and a happy staff means a happy community.
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Melissa is here in Washington, DC this week to join several hundred other small businesses for the U.S. Chamber of Commerce's 14th annual Small Business Summit. Many of us were on Capitol Hill yesterday meeting with our senators to help explain how we are putting tax reform savings to work by reinvesting in our employees, our

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[1] Findings from an Ipsos poll of 1,000 small business owners and operators conducted by phone between June 14 and July 27, 2018. Results may be found at: https://www.uschamber.com/sbindex/SBI_2018_Q3.pdf.

[2] Findings from an Ipsos poll of 1,000 small business owners and operators conducted by phone between January 8 – January 25, 2018. Results may be found at: https://www.uschamber.com/sbindex/SBI_2018_Q1.pdf.

businesses, and our communities. These examples of how we are re-investing tax cut savings to provide higher salaries and increased benefits for our employees are echoed by small businesses throughout the United States.[3]

In my small business, our employees are taking home more of their earnings and many of our clients are benefitting from the Tax Cuts and Jobs Act. One of those clients, timber company RoyOMartin, announced the opening of a new state-of-the-art Oriented Strand Board (OSB) plant in Corrigan, Texas this past May.[4] At full capacity, the plant will ship enough OSB for approximately 70,000 U.S. homes per year. RoyOMartin's investment in the new plant created 165 direct jobs and more than 470 indirect jobs in construction.

Another example is ExxonMobil, which announced that it is reinvesting $50 billion in its U.S. operations because of the Tax Cuts and Jobs Act. That was music to the ears of my client, ExxonMobil Baton Rouge, which employs more than 6,500 people in my state. As a practical matter, my job as an organizational consultant is less difficult when employees are taking home more pay and the company they work for is committed to reinvestment and growth. The tax cuts will allow them to make additional investments in operations and staffing. This example shows the positive ripple effect of business confidence and optimism due, in part, to tax reform.

Our organizational consulting firm has seen an increase in business this year. Our clients are doing well and they want to remain competitive by working with us on strategic planning and making sure they retain their talented employees in this tight labor market.

Improvements Needed for Tax Reform to Have an Even Greater Positive Impact:

Finally, we would like to work with the Committee and your colleagues on the Finance Committee to make the small business tax cuts permanent. Many of us want to plan ahead, whether it is to grow our businesses, sell our businesses, or pass what we have built on to our children. The expiration of several tax benefits at the end of 2025 will limit our ability to implement expansion or transition plans for our businesses.

We look forward to working with you on ways to improve the tax code through legislative action and we appreciate your attention to the ongoing benefits of the Tax Cuts and Jobs Act for the small business community by holding this hearing.

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[3] See a map of businesses that are reinvesting tax cut savings at: https://www.uschamber.com/tax-reform.

[4] RoyOMartin is a forestry-related and wood-products manufacturing company based in Alexandria, Louisiana that employs 1,110 workers in their two manufacturing facilities.

Senator RUBIO. Thank you, Dr. Slaughter.
Mr. Lettieri.

STATEMENT OF JOHN LETTIERI, CO-FOUNDER AND PRESIDENT, ECONOMIC INNOVATION GROUP, WASHINGTON, DC

Mr. LETTIERI. Well, good afternoon, Senator Rubio, Ranking Member Cardin, and members of the Committee.

My name is John Lettieri. I am the president and CEO of the Economic Innovation Group, a bipartisan research and advocacy organization. Thanks for inviting me to testify today regarding Opportunity Zones.

Opportunity Zones are the most innovative and ambitious Federal attempt to encourage private investment in low-income communities in at least a generation. While this incentive was designed to support a wide variety of needs, its central purpose was to drive investment into operating businesses in underserved areas, particularly new ventures and existing small- to medium-sized businesses poised for growth. This fundamental goal must now be reflected in the rulemaking process in order for Opportunity Zones to meet its full dynamic potential.

Before going further, I want to briefly address the issue that prompted the development of Opportunity Zones in the first place, namely the uneven economic recovery from the Great Recession.

While there is much to celebrate regarding the strength and resilience of the U.S. economy today, far too many communities are still being left on the sidelines. The geographic distribution of jobs, businesses, and wage gains during the recovery has been highly concentrated.

One finding from a forthcoming EIG report helps to illustrate this point. As of the end of 2016, less than one-quarter of U.S. counties have recovered the businesses lost to the Recession. Regional inequality is a growing challenge, and Opportunity Zones is the first major Federal effort since the Recession to address it.

The first phase of implementation was the selection of the Opportunity Zones themselves, the areas where certain investments would be eligible for the tax benefit. Congress set a national framework for eligibility and tasked governors with selecting and submitting their nominations to Treasury based on local input and priorities.

Meeting the tight deadline in a thoughtful manner required a Herculean effort on behalf of governors, their staffs, their local partners, as well as officials within the Treasury Department, and all parties involved rose to the challenge. Governors selected significantly higher-need places on average than the law required but worked hard to strike the appropriate balance between local need and market opportunity.

The following statistics are from EIG's analysis of the nearly 8,700 Opportunity Zones nationwide. First, the poverty rate in the average Opportunity Zone tract is 31 percent, and the median household income is only 59 percent of its State or regional median. Approximately 10 percent of the U.S. population now lives in an Opportunity Zone, and minorities make up 56 percent of that population.

Governors were intentional about including rural areas and nominated a proportional number of rural Census tracts in terms of what was eligible.

According to data from the Urban Institute, fewer than 4 percent of the designated tracts have experienced rapid socioeconomic change since the year 2000, and three-quarters of the zones are located in ZIP codes that have seen at least some level of post-Recession employment growth. These findings demonstrate the dimensions of economic need in the average Opportunity Zone as well as the opportunity itself.

The success of the first phase of implementation helped to accelerate the grassroots momentum and interest we see around the country today. I have spent the last 10 months traveling to audiences around the country, meeting with various stakeholders in the private sector, the public sector, the philanthropic sector, and I can say there is tremendous excitement.

So what will it take to turn market interests into investor action and community benefit? While there are many factors in play, realizing the potential of Opportunity Zones hinges first and foremost upon timely and effective regulatory rulemaking, and the rules themselves must be from the outset geared to facilitate investment in operating businesses, not simply real estate.

To that end, Treasury must address the following threshold issues. First, we need definitional clarity. The statute gives Treasury broad latitude to define a number of important requirements and tests, including issues related to the eligibility of an Opportunity Zone business and the nature of a qualifying investment. These rules must be designed with practical considerations and basic market flexibility in mind.

Second, timing clarity. Qualified Opportunity Funds, the vehicles through which all Opportunity Zone investment must be made, need adequate time to raise capital, conduct due diligence, and build their portfolios.

And, third, clarity about the benefit. The Opportunity Fund structure is one of the most important features of this incentive precisely because it is the key to facilitating investment in businesses. Investors have a number of questions regarding how fund-level activity, including the sale of a portfolio asset, impacts the tax benefit.

These issues are central to the success of Opportunity Zones and must be addressed before the market can move its scale.

My primary hope for this policy, one shared by State and local officials, community organizations, and investors alike, is that it will succeed where other policies and programs have fallen short, namely by providing a true lifeline to entrepreneurs in underserved and overlooked communities nationwide. I firmly believe this goal is within grasp.

So thank you for holding this hearing, and I look forward to answering your questions.

[The prepared statement of Mr. Lettieri follows:]

JOHN W. LETTIERI
PRESIDENT & CEO
ECONOMIC INNOVATION GROUP

TESTIMONY BEFORE THE U.S. SENATE COMMITTEE ON
SMALL BUSINESS AND ENTREPRENEURSHIP

"Expanding Opportunities for Small Businesses Through the Tax Code"

October 3, 2018

Introduction

Chairman Risch, Ranking Member Cardin, and members of the Committee:

My name is John Lettieri and I am the President and Chief Executive Officer of the Economic Innovation Group (EIG), a bipartisan research and advocacy organization based in Washington, DC. Thank you for inviting me to testify regarding implementation of the new Opportunity Zones tax benefit, which became law as part of the *Tax Cuts and Jobs Act of 2017* (TCJA), and holds the potential to promote much-needed economic growth in struggling communities nationwide.

EIG was deeply involved in the development of the *Investing in Opportunity Act (IIOA)*, which garnered broad bipartisan support and served as the basis of the Opportunity Zones provision in the TCJA. We were honored to work closely with several members of this committee, including Senators Tim Scott (R-SC) and Cory Booker (D-NJ), the lead sponsors of IIOA. Since Opportunity Zones became law, we have worked with an array of important stakeholders nationwide, including state and local policymakers, community organizations, major philanthropies, and leading investors to raise awareness, provide analysis, and gather feedback. Those efforts helped to inform detailed technical recommendations that we, alongside a coalition of stakeholders, provided to the Department of Treasury and Internal Revenue Service (IRS) in support of timely and effective implementation.[1]

Opportunity Zones are the most innovative and ambitious federal attempt to encourage long-term private investment in low-income communities in at least a generation. While the incentive was designed to support a wide variety of needs across communities, its central purpose was to drive investment into operating businesses in underserved areas – particularly *new* ventures and existing small- to medium-sized businesses poised for growth. This fundamental goal must now be reflected in the rulemaking process. Simply put, if in practice the forthcoming regulatory framework inadvertently biases the tax benefit towards real estate investment or hampers the formation of multi-asset funds to invest in operating businesses, it will fail to achieve its true

[1] Economic Innovation Group Opportunity Zones Coalition. "Economic Innovation Group Opportunity Zones Coalition Letter." Received by U.S. Department of the Treasury and David J. Kautter, 18 June 2018. Letter. https://eig.org/wp-content/uploads/2018/06/Opportunity-Zones-Coalition-Letter_6.18.18.pdf

dynamic potential. Instead, Opportunity Zones would be at risk of repeating the shortcomings and narrow scope of past policy efforts.

Why are Opportunity Zones needed?

Before going further, it is worth briefly addressing the issue that prompted the development of Opportunity Zones: the deeply uneven economic recovery from the Great Recession. While there is much to celebrate regarding the strength and resilience of the U.S. economy at the national level today, far too many communities are being left on the sidelines in the midst of a prolonged economic expansion. The *geographic* distribution of jobs, businesses, and wage gains during the recovery has been highly concentrated. One finding from forthcoming EIG research helps to illustrate this point: As of the end of 2016, less than *one quarter* of U.S. counties had gained back the number of businesses they lost to the recession. I believe regional inequality within the United States will be recognized as one of the defining economic challenges of our era, and Opportunity Zones is the first major federal effort to address it.

The map of Opportunity Zones

One of the most important features of the Opportunity Zones policy is the role given to governors in determining where the incentive will apply. Congress established a national framework to identify the census tracts eligible to become Opportunity Zones, but tasked governors with down-selecting and submitting their nominations based on local input and priorities. On the whole, governors did an effective job in managing a thoughtful, analytical, and rigorous selection process nationwide. They tailored their selections to the need and potential of their communities, and relied heavily on public and local government engagement, analytics, peer-learning, and interagency collaboration.

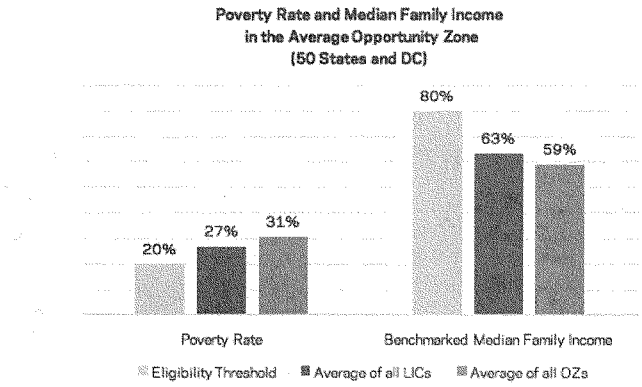
Governors selected significantly higher-need places on average than the law required, but worked hard to strike the right balance between local need and market opportunity. The following are statistics from EIG's analysis of the nearly 8,700 certified Opportunity Zones in the United States and territories.

- Roughly 10 percent (31.3 million) of the U.S. population resides in Opportunity Zones.[2]
- The poverty rate in the average tract is 31 percent.
- The median household income in the average tract is only 59 percent of its state or regional median.
- Nearly 70 percent of the population in Opportunity Zones resides in a census tract that is "severely distressed" according to the U.S. Treasury Department's CDFI Fund.
- The average life expectancy in Opportunity Zones is a full three years shorter than the national average.
- The median home is more than a decade older in Opportunity Zones than it is nationally.
- Thirty-eight percent of resident adults in designated areas are not working, which is 10 points above the national rate.

[2] The number grows to 35 million when including the U.S. territories and Puerto Rico.

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PRESIDENT & CEO
ECONOMIC INNOVATION GROUP

- Three-quarters of zones are located in zip codes that experienced at least some level of post-recession employment growth from 2011-2015.
- Minorities make up 56 percent of the Opportunity Zones population.
- Fewer than four percent of the designated tracts have experienced rapid socioeconomic change (a proxy for gentrification) since 2000.[3]



These findings demonstrate the dimensions of economic need in the typical Opportunity Zone. While not a panacea, this incentive could become a powerful new tool to reverse local decline and promote inclusive growth if it is deployed in a thoughtful and strategic manner. No incentive is, by itself, a placemaking strategy.

Early implementation success

Treasury deserves significant credit for the way it managed the first phase of implementation: the designation of Opportunity Zones nationwide. The statute gave governors 120 days to submit nominated census tracts to Treasury for approval. Meeting this tight deadline in a thoughtful and orderly fashion required a herculean effort on behalf of governors, their staffs, and their local partners—as well as officials within the Treasury and the CDFI Fund. All parties involved rose to the challenge with enthusiasm and a real sense of mission and possibility. Treasury ensured that eligibility criteria, an impressive mapping interface, and instructions for submission were all made available to governors well ahead of the deadlines. Treasury was responsive throughout the process and certified the selected tracts in a timely manner. It was federalism working at it smoothest, just as I am sure Congress intended. The success of that first phase of implementation helped accelerate the grassroots momentum and interest we see around the country today.

[3] Theodos, Brett, et al. *Opportunity Zones Investment Score Dataset.* Urban Institute. Opportunity Zones: Maximizing Return on Public Investment.

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Looking ahead to proposed rulemaking: ensuring new and small businesses can benefit

Since Opportunity Zones became law, the response among community leaders, state and local officials, private sector investors, and other stakeholders has been precisely what Congress envisioned. Congress understood that for the incentive to reach a wide array of places, it needed to be flexible enough to draw in a wide array of investors, who, in turn, could deploy capital to meet a range of local needs. To date, the broad and intense interest from stakeholders reflects the ambitious goals of this policy.

So, what will it take to turn interest into action? While there are many factors in play, the potential of Opportunity Zones hinges first and foremost upon timely and effective regulatory rulemaking. Investors have yet to receive the formal guidance or regulatory clarity needed to inform their decision-making. As a result, the market is not yet responding at scale and capital largely remains on the sidelines—even as the clock is ticking for this perishable incentive. However, additional clarity appears to be coming soon, as the first round of proposed rulemaking is now under review in the Office of Information and Regulatory Affairs (OIRA).

As I noted earlier, successful implementation will require rules that are fundamentally geared to facilitate investment in operating businesses. To that end, Treasury must address the following threshold issues early in the rulemaking process:

- **Definitional clarity:** The statute gives Treasury broad latitude in defining a handful of critical terms in a manner appropriate for carrying out Congressional intent, including definitions pertaining to the eligibility of a Qualified Opportunity Zone business and the nature of a qualifying investment. These rules must be designed with practical considerations and basic market flexibility in mind. If too narrow in scope or impractical in nature, the rules would undermine the very purpose for which this incentive was created.

- **Timing clarity:** Qualified Opportunity Funds (QOFs),[4] the vehicles through which all Opportunity Zone investments must be made, were intended to encourage broad participation by allowing multiple taxpayers to pool their resources and spread the risks and costs of investment across a portfolio of businesses or business properties. Funds, however, need adequate time to raise capital, conduct due diligence, and build their initial portfolio of investments. Treasury's rules should include an "on-ramp" period that allows newly-formed Funds time to conduct these activities.

- **Benefit clarity:** The Qualified Opportunity Fund structure is one of the most important features of the Opportunity Zones incentive precisely because it is key to facilitating investment in operating businesses. The statute links the benefit to a taxpayer's investment in a QOF over a duration of time, rather than a QOF's holding in any particular investment. As noted above, Congress intended QOFs to have the ability to

[4] A Qualified Opportunity Fund must invest at least 90 percent of its assets in Qualifying Opportunity Zone business stock, partnership interest, or business property.

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> operate as true portfolio funds – allowing investors to achieve greater scale and mitigate risk by pooling capital together and deploying it in a variety of investments. Furthermore, Congress anticipated that a QOF would not necessarily hold each of its portfolio investments for the entire duration of the Fund, but would instead make initial investments and then seek to reinvest later as capital was returned to the Fund from the sale of an asset. This again is critical for QOFs that intend to invest in operating businesses – particularly new businesses – which are inherently less predictable than real estate projects. Treasury's rules and guidance should affirm that Fund-level "churn" does not interrupt the tax benefit to an investor in a QOF.

These issues are central to the success of Opportunity Zones. Until they are addressed, a significant share of interested investors will remain on the sidelines, investment in operating businesses within the zones will be muted, and the overall scope and diversity community impact will be limited. I stress this point because federal policies have a generally poor track record when it comes to boosting private investment in operating businesses – especially early stage ventures. My primary hope for Opportunity Zones implementation – one shared by state and local officials,[5] community organizations, and investors alike – is that it will succeed where other policies and programs have fallen short: by providing a true lifeline to entrepreneurs in underserved and overlooked areas of our country. I firmly believe this goal is within reach.

Thank you, and I look forward to taking your questions.

[5] The United States Conference of Mayors, The United States Conference of Mayors to The Honorable David J. Kautter, Received by U.S. Department of the Treasury and David J. Kautter, 23 August 2018. Letter. https://www.novoco.com/sites/default/files/atoms/files/request_for_guidance_082318.pdf

Senator RUBIO. Thank you.
Mr. Arensmeyer.

STATEMENT OF JOHN ARENSMEYER, FOUNDER AND CHIEF EXECUTIVE OFFICER, SMALL BUSINESS MAJORITY, WASHINGTON, DC

Mr. ARENSMEYER. Senator Rubio, Ranking Member Cardin, and fellow members of the Committee, thank you very much for inviting me to speak with you today.

I was a long-time small business owner prior to founding Small Business Majority 13 years ago. With our network of 58,000 small business owners across the country and eight regional offices, we actively support public policy solutions and deliver resources to entrepreneurs in order to drive a strong, inclusive, small business-centric job-creating economy.

Because Congress is considering making the tax cuts that were in the tax law permanent, I think it is important to take a look at where we are and what the tax law does and does not do.

As the Ranking Member has stated, the law was a missed opportunity to foster entrepreneurship primarily benefiting large corporations and wealthy individuals, not Main Street small businesses, while dramatically increasing the deficit by $1.5 trillion.

First, a top priority of this legislation was to slash corporate tax rates from 35 percent to 21 percent, even though only 5 percent of small businesses pay corporate taxes.

Second, the law's treatment of pass-through income gives the bulk of the benefits to the wealthiest pass-through entities rather than to Main Street. Let us remember that less than 2 percent, exactly 1.7 percent of all pass-through businesses, with average profits of three-quarters of a million dollars account for the majority of all pass-through income.

Data from the Joint Committee on Taxation reveals a whopping 44 percent of the new pass-through deductions; $17.8 billion will benefit approximately 200 individuals making $1 million or more. By 2024, this skewed benefit will almost double to $31.6 billion.

Moreover, according to the JCT report, the majority of the 2018 tax reduction benefit will go to the top 2.3 percent of pass-through firms, and by 2024, that percentage drops to 1 percent.

Clifton Broumand, owner of Man & Machine, a medical keyboard and mouse manufacturer in Landover, Maryland, echoes these facts, noting that the tax bill was designed for businesses at the top of the food chain, not businesses like him.

Jessica Jolly, a solo-entrepreneur, digital skills coach in Evanston, Illinois, concurs saying the tax law has not done anything to help incentivize small business growth or retention.

Recent polling from ZipBooks found 88 percent of small business owners say the new tax cuts have had no impact on their hiring decisions.

This is why last year we proposed a different solution that would have benefited small businesses from the bottom up by allowing businesses to deduct their first $25,000 in business income with a phase-out at higher income levels. This would have ensured a significant direct benefit to true Main Street businesses as opposed to large businesses, hedge funds, and the very wealthy.

Our proposal appealed to Nancy Clark, owner of Drive Brand Studio, a 10-person marketing and PR firm in North Conway, New Hampshire. She noted that the 2017 tax cuts have not done anything for her, and that a bottom-up approach would have helped small businesses by allowing them to truly reinvest in their businesses.

Third, the complexity of the new deduction means that any savings will likely go toward tax professionals to help entrepreneurs navigate the new law. Indeed, the National Small Business Association found in a survey earlier this year that a mere 7 percent say they think filing taxes will become easier under the new law.

And, finally, a Tax Code with a large gap between top individual rates and to pass-through rates will encourage some wealthy individuals to game the system by simply declaring themselves pass-through business entities.

But given what the law is, what can we do going forward? We have some recommendations.

To echo what John has said, we need to ensure that Opportunity Zone guidelines are designed to benefit Main Street small business owners rather than focusing on incentivizing real estate development.

We need to make the new markets tax credit permanent. It is expiring next year.

We need to align form 1099 reporting thresholds and streamline income reporting for independent workers.

We need to identify and fix tax issues unique to micro-enterprises and freelancers, such as burdensome quarterly tax filings.

We need to establish a standard business deduction for independent entrepreneurs.

And, finally, we need to finally pass health care tax equity for the self-employed so that freelancers can deduct their health care expenses from their FICA tax obligations, just like other business entities.

I am happy to discuss these recommendations in more detail with the Committee.

Thank you.

[The prepared statement of Mr. Arensmeyer follows:]



WRITTEN STATEMENT

BEFORE THE U.S. SENATE COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP

HEARING ON

"EXPANDING OPPORTUNITIES FOR SMALL BUSINESS THROUGH THE TAX CODE"

October 3, 2018

John Arensmeyer, Founder & CEO

Small Business Majority

Chairman Risch, Ranking Member Cardin and fellow members of the Committee,

Thank you for inviting me to speak with you today about opportunities for entrepreneurship throughout America.

I was a long-time small business owner prior to founding Small Business Majority 12 years ago. For 13 years, I was the founder and CEO of ACI Interactive, an award-winning interactive communications company, and earlier I was the chief operating officer of a pioneering multimedia business. Following my years of experience running small businesses, I founded Small Business Majority to create a national organization to serve as a leading advocate for America's entrepreneurs.

Small Business Majority's mission is to empower America's entrepreneurs to build a thriving and inclusive economy. We actively engage small business owners and policymakers in support of public policy solutions, and deliver information and resources to entrepreneurs that promote small business growth and drive a strong, job-creating economy. Our extensive scientific opinion polling, focus groups and economic research help us educate and inform policymakers, the media and other stakeholders about key issues impacting small businesses and freelancers, including access to capital, taxes, healthcare, retirement and critical workforce issues.

Small Business Majority has a network of 58,000 small business owners across the country, with eight regional offices. We work closely with our network and with more than 1,000 local business groups to create a strong small business voice in Washington and state capitals, and deliver critical education and resources to America's job-creating entrepreneurs. Through our Entrepreneurship Program, we offer free education, tools and events to small business owners and aspiring entrepreneurs about access to responsible lending options, retirement, healthcare, wealth building tactics and more.

A thriving small business ecosystem is central to creating a dynamic and inclusive American economy. America's 30 million small businesses represent 99% of all employer firms and account for half of our nation's jobs and economic output, and their creativity spurs innovation in all sectors of the economy. According to the U.S. Small Business Administration, small businesses have created

two out of three new private-sector jobs since the Great Recession.[1] Private-sector job creation at small- and medium-sized businesses has outpaced the rate of large-size companies for every month of 2017, per ADP's National Employment Report.[2]

It is because of this undeniable importance that the decline in the rate of business formation is particularly troubling. According to the U.S. Census Bureau, 414,000 startups were created in 2015, down from the pre-recession average of 524,000 between 2002 and 2006, a roughly 25% decline.[3] That translates to fewer jobs created by startups, and less innovation in our economy. We must pursue and enact policies that will reverse this trend and enable entrepreneurs to unleash their potential and boost prosperity for all.

The 2017 Tax Cuts and Jobs Act was a missed opportunity to encourage entrepreneurship and streamline policies that reduce red tape for our nation's small business owners. Indeed, we believe the law will hurt small businesses and the economy because it will increase the deficit by $1.5 trillion without giving Main Street a real tax break. Despite the failure to enact meaningful tax reform for our nation's entrepreneurs with the Tax Cuts and Jobs Act, there are numerous concrete tax policies legislators should consider to expand opportunities for small businesses, especially for our nation's 22 million solo entrepreneurs.

The 2017 Tax Cuts and Jobs Act left Main Street small businesses behind

The Tax Cuts and Jobs Act was written to the benefit of large corporations and wealthy individuals, not Main Street small businesses. A priority of this legislation was to slash corporate tax rates from 35% to 21% even though only 5% of small businesses pay corporate taxes.[4] Adding $1.5 trillion to the deficit at a time of economic prosperity will do nothing to help small businesses, and it certainly doesn't level the playing field.

Additionally, the law's treatment of pass-through entities gives the bulk of the benefit to the wealthiest pass-through entities, rather than Main Street. Indeed, data from the Joint Committee on Taxation (JCT) reveals a whopping 44% of the new pass-through deduction ($17.8 billion) will benefit approximately 200,000 individuals making $1 million or more.[5] In 2024, this will increase to $31.6 billion.

According to the JCT report, the majority of the 2018 tax reduction benefit will go to the top 2.3% of pass-through firms, and by 2024 that percentage drops to one percent.[6] A business owner with $600,000 per year will save almost 25 times that of an owner with $75,000 in income, despite only earning eight times more. According to the Small Business Administration, the median income for individuals self-employed at their own incorporated businesses was $50,347 in 2016.[7] It is also important to note that not all pass-through businesses are small firms: According to the Tax Policy Center, less than two percent (1.7%) of all pass-through businesses, with average profits of three-

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[1] Small Business Administration FAQs, June 2016, https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf
[2] ADP National Employment Report, January-August 2017, http://www.adpemploymentreport.com/
[3] "A Start-Up Slump Is a Drag on the Economy. Big Business May Be to Blame," *The New York Times*, September 2017, https://www.nytimes.com/2017/09/20/business/economy/startup-business.html
[4] Brookings Institution, "Nine facts about pass-through businesses," May 2017, https://www.brookings.edu/research/9-facts-about-pass-through-businesses/
[5] Joint Committee on Taxation, "Tables Related to the Federal Tax System as in Effect 2017 through 2026," April 2018, https://www.jct.gov/publications.html?func=startdown&id=5091
[6] Ibid.
[7] Small Business Administration, 2018, https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf

quarters of a million dollars, account for the majority of all pass-through income—hardly your typical Main Street small business.[8]

Jessica Jolly, a solo-entrepreneur in Illinois and a member of our Small Business Council, told us that she doesn't feel the tax law did anything to help incentivize small business growth or retention, particularly for people like her—independent small business owners in their 50s and 60s who are leaving the corporate world but not ready for retirement. She noted that rather than wasting resources by giving corporations a break, the tax system should encourage more people to start businesses or to become solo-entrepreneurs.

Policymakers missed a once-in-a-generation chance to craft tax reform that would have made life easier for America's small businesses. This is why we proposed a different solution that would have benefitted small businesses from the "bottom up" during the debate over tax reform last year. Specifically, we proposed allowing small businesses to deduct their first $25,000 in business income whether or not they file their tax returns as a pass-through entity or as a C-Corporation. This would have ensured that changes to the tax code would have a significant, direct benefit to small businesses and self-employed individuals as opposed to large businesses, hedge funds and the very wealthy.

A proposal like this appealed to Nancy Clark, a member of our Small Business Council and owner of Drive Brand Studio, a small business focusing on marketing and PR in New Hampshire. She noted that the 2017 tax cuts didn't do anything for her as a small business owner, and that a bottom-up tax approach would have helped small businesses by allowing them to truly reinvest in their business. She added that legislation should instead focus on creating tax rates that benefit small businesses of all sizes to help them compete with big business. She said, "I truly believe the tax law was never meant to benefit true small businesses like me. It's unfortunate for me and my fellow New Hampshire small businesses because 'mom and pop' shops and small local firms like mine are the backbone of this state and our country. To see the tax law not provide support for us is truly disappointing, to say the least."

Tax cuts are too complicated, allow for more loopholes and won't spur investment

The tax cuts are structured in a way that is convoluted and benefits those at the top far more than lower-income business owners, with the majority of benefits going to the wealthiest pass-through business entities. Small business owners who do see any benefit will not receive enough savings to grow or invest back in their businesses.

A report co-authored by Anne Zimmerman, a member of our national Small Business Council who owns a small public accounting firm in Ohio, found the 20% deduction on qualified business income is unlikely to generate enough savings for real small businesses to hire new employees, invest back into their businesses or make operational improvements.[9] Additionally, recent polling from ZipBooks, an online accounting software company that serves more than 100,000 small businesses, found 88% of small business owners say the new tax cuts have had no impact on their hiring decisions.[10]

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[8] Tax Policy Center, "Distribution of Business Income, by Statutory Marginal Tax Rate; Current Law, 2017," March 2017, https://www.taxpolicycenter.org/model-estimates/distribution-business-income-march-2017/distribution-business-income-statutory

[9] Businesses for Responsible Tax Reform, "The Tax Cuts and Jobs Act: Implications for Small Businesses," May 2018, https://docs.wixstatic.com/ugd/4a8609_5ae6299d49534af6b27acb872d044e30.pdf

[10] ZipBooks, "Tax cuts advertised to fuel spending on jobs, yet small business owners feel differently," September 2018, https://zipbooks.com/blog/tax-cuts-impact-on-small-business-owners/

The complexity of the new deduction means that any savings will likely go towards tax professionals to help entrepreneurs navigate their taxes. Small Business Majority member Clifton Broumand, Owner of Man & Machine Inc., a medical keyboard and mouse manufacturer in Landover, Maryland, noted that he feels like the tax bill was designed for businesses at the top of the food chain, not small businesses like his. He added that the process of filing taxes has gotten even more difficult, and he has seen no benefit or savings from the tax law.

Given these sentiments, it's not surprising that the National Small Business Association found in a recent survey of its members that a mere 7% say they think filing taxes will become easier under the new tax law, and 1 in 3 say they already spend more than 40 hours each year on federal taxes.[11] An additional 1 in 3 say businesses plan to, or are considering, switching from a pass-through entity to a C-Corporation as a result of the Tax Cuts and Jobs Act, with the majority saying the temporary nature of the small business tax cuts is an issue for their business.

And importantly, a tax code with a large gap between top individual rates and top pass-through rates will encourage some wealthy individuals to game the system by simply declaring themselves pass-through business entities. While the new law exempts certain industries from accessing the pass-through rate, there is no way to guard against all abuse of the pass-through rate and ensure that this does not primarily benefit hedge fund managers, lobbyists, lawyers and investment bankers—rather than Main Street small businesses.

Simply put, small business owners wanted a simplified and more streamlined tax system that would also help level the playing with large corporations, and they got the opposite.

Policy recommendations to better serve our nation's entrepreneurs

Now that the 2017 Tax Cuts and Jobs Act is established law, we must turn to concrete policy solutions that could better serve our nation's entrepreneurs within the reformed system. This includes the following recommendations:

- **Ensure Opportunity Zones guidelines are designed to benefit Main Street small business owners rather than focusing on incentivizing real estate development.** As to date, little detail has been revealed about how investments in Opportunity Zones enacted by the 2017 Tax Cuts and Jobs Act will be implemented. While these investments hold the potential to benefit small businesses, especially those in underserved communities, they must be implemented responsibly. This could include requiring reporting metrics that measure program success based on the number of jobs created, where those jobs are located, employee wages and the number of businesses created, particularly businesses formed by women or people of color.
- **Make the New Markets Tax Credit permanent**. This tax credit, which is set to expire at the end of 2019, has helped attract more than $60 billion in private sector funding to build businesses in economically-distressed communities across the United States.
- **Align form 1099 reporting thresholds and streamline income reporting for independent workers**. Independent workers receive either a Form 1099-MISC or a Form 1099-K depending on how they are paid—if they are paid via cash or check, they receive a 1099-MISC if they are paid $600 or more. However, if they are paid electronically, they only receive a 1099-K if they receive at least $20,000 in payments and are involved in more than 200 transactions with that network. These independent contractors are still required to pay taxes on income received below this threshold, but are expected to track and report their own

[11] National Small Business Association, 2018 Small Business Taxation Survey, http://nsba.biz/wp-content/uploads/2018/04/Tax-Survey-2018.pdf

earnings without documentation, which increases the likelihood that an independent contractor could misreport their earnings and leaves them vulnerable to costly penalties. Aligning the reporting requirements so all independent contractors receive documentation for income above $600, regardless of how they receive that payment, could ease their administrative burden while also increasing compliance.

- **Identify and fix tax issues unique to micro-enterprises and freelancers, such as burdensome quarterly tax filings for freelance employees**. These quarterly filing requirements, mandatory for any freelancer who will owe more than $1,000 annually to the IRS, are burdensome and leave independent workers vulnerable to costly fees. Reforms should be considered that would require some types of companies to withhold on behalf of independent contractors, in cases such as:
    - The independent contractor receives more than $600 in payments;
    - The freelancer is not an incorporated business;
    - The payer issues 100 or more Form 1099s each year.
- **Establish a standard business deduction for independent workers.** Independent workers must currently track and keep records of all business expenses, such as supplies, vehicle costs and other fees, and subtract against their income. This is a burdensome and complicated process. A standard business deduction in line with personal standard deductions could streamline the deducting of business expenses for solo-entrepreneurs.
- **Pass healthcare tax equity for the self-employed** so that freelancers can deduct their healthcare expenses from their FICA tax obligations—just like other business entities.

Conclusion

Small business owners don't want special treatment in the tax code; they simply want to compete on a level playing field. America's entrepreneurs shouldn't have to navigate a tangled web of tax code to operate and grow their business. This is why we need a tax code that benefits America's entrepreneurs who are focused on growing their enterprises and making payroll at the end of each month. While we missed the opportunity to enact meaningful reform for entrepreneurs last year, there is still much that can be done to benefit our nation's small business owners and encourage more entrepreneurs to follow their dreams, both through ensuring investment in Opportunity Zones lives up to its potential for small business and through further responsible tax reforms.

Thank you for the opportunity to comment on this important issue for America's small business community. I would be happy to answer any questions.

Senator RUBIO. Thank you.
And, finally, Ms. Bruckner.

STATEMENT OF CAROLINE BRUCKNER, MANAGING DIRECTOR, KOGOD TAX POLICY CENTER, AMERICAN UNIVERSITY, WASHINGTON, DC

Ms. BRUCKNER. Committee members and staff, my name is Caroline Bruckner, and I am a tax professor on the faculty at American University's Kogod School of Business. I also serve as the managing director of the Kogod Tax Policy Center, which conducts nonpartisan policy research on tax and compliance issues specific to small businesses and entrepreneurs. We have two key areas of expertise—gig economy and 1099 workers—their tax compliance issues as well as women business owners and the Tax Code.

Thank you for inviting me, and by extension, the AU undergraduate students in my Federal Income Taxation class, who are here with us today, to talk about expanding opportunities for small businesses through the Tax Code.

I am going to speak quickly because I have a lot to say.

This Committee has a long history of dating back to its days as a Senate select committee in the 1950s of working on behalf of America's small businesses on tax issues and has held more than 40 hearings over the years on tax-related concerns of small businesses.

I should know. Prior to joining AU's faculty, I served on the staff of this Committee from 2009 to 2014, ultimately as Chief Counsel. My work on this Committee led me to conduct groundbreaking research published in 2017 in a report entitled "Billion Dollar Blind Spot—How the U.S. Tax Code's Small Business Tax Expenditures Impact Women Business Owners." There is no question that taxation plays a key role in the survival and growth of small businesses, primarily through its effect on equity infusion. In fact, it is also a fact that 99 percent of women-owned firms are small businesses.

Existing research generally and by this Committee in particular, specifically Senator Shaheen, has consistently found out that—has consistently found that women business owners struggle to access capital to grow and scale their businesses. This is a common complaint among smaller firms. It is not unique to women-owned firms, just more acute.

In "Billion Dollar Blind Spot," we detail the legislative history and congressional intent to provide access to capital and opportunities for growth to small businesses with four tax expenditures: first, Section 1202, 100 percent exclusion of capital gains tax for investment in qualified small business stock; Section 1244, ordinary loss treatment for investments in qualified small business stock; Section 179, accelerated depreciation for small businesses; and Section 195, which is the $5,000 deduction for qualified startup costs.

This research is particularly relevant in today's economy because although the 12 million women business owners operating today account for 40 percent of all U.S. firms, they remain small businesses, primarily operating as service firms, and continue to have challenges accessing capital.

Women of color are leading this charge. These firms grew at a rate of 163 percent during the last 10 years, and today, women of color own 64 percent of the new women-owned businesses launched each day.

Yet despite this extraordinary growth, our report is the first to assess how more than $275 billion of tax expenditures targeted to help small businesses access capital and grow impact women-owned firms, and we found that three of the four small business tax expenditures we studied are so limited in design that they either explicitly exclude service firms—and by extension, the majority of women-owned firms—or could effectively bypass women-owned firms who are not incorporated or who are service firms with few capital-intensive equipment investments altogether.

Our survey data of over 500 women business owners corroborates these findings and nevertheless suggest that when women-owned firms can take advantage of tax breaks, they do.

Our research also suggests the immediate need for Congress to conduct oversight into a formal accounting as to how tax expenditures create opportunities for women-owned businesses to access capital.

Our research shows that Congress and stakeholders have a billion-dollar blind spot when it comes to understanding how effective small business tax expenditures are with respect to women-owned firms.

In addition, Congress may have doubled down on its billion-dollar blind spot as part of tax reform. Two key provisions of the bill reflect additional taxpayer-funded investments that our research suggests are less favorable to women business owners.

For example, according to JCT, more than 90 percent of the $415 billion revenue loss generated from Internal Revenue Code Section 199A will flow to firms with income of more than $100,000 in 2018. However, 88 percent of women business owners generate revenues less than $100,000.

This inequitable distribution is even more pronounced when considered at higher income levels. Only 1.7 of women business owners have receipts of $1 million or more, but 44 percent of the revenue loss will flow to businesses with $1 million or more of income. And those women business owners with revenues of $1 million or more are more likely to be in services and excluded altogether.

This Committee should be congratulated on holding this hearing and immediately set to work to develop the needed research to understand how and whether existing tax incentives create opportunities for women-owned firms to access capital.

As next steps, we recommend the Committee employ the following strategies to develop the necessary research on these issues, including requesting the congressional tax-writing committees hold joint hearings together with this Committee on the small business tax issues identified in our research and in this testimony and, two, requesting the Joint Committee on Tax develop estimates on how small business expenditures impact women-owned firms in terms of the revenue loss distribution.

In addition, we are so pleased to see our recommendations to align the 1099 filing recommendations be supported by small busi-

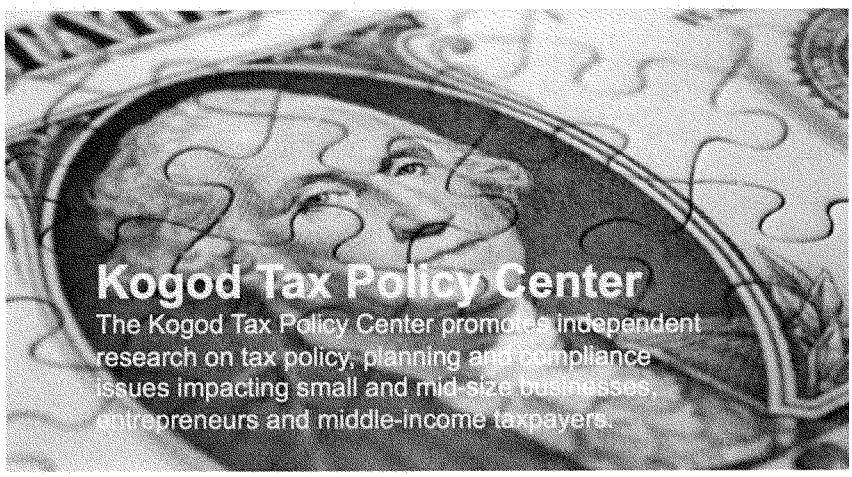
ness majority. Hopefully, with their support, we can get this finally done over the finish line.

We stand ready to aid the Committee in this important work on behalf of millions of small businesses impacted by these issues.

Thank you so much, and I am happy to answer any questions that you might have.

[Then prepared statement of Ms. Bruckner follows:]

KOGOD SCHOOL *of* BUSINESS
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Expanding Opportunities for Small Businesses Through the Tax Code

Hearing of the United States Senate Committee on Small Business and Entrepreneurship

Wednesday, Oct. 3, 2018

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Chair Risch, Ranking Member Cardin, Committee Members and Staff, my name is Caroline Bruckner and I am a tax professor on the faculty at American University's Kogod School of Business. I also serve as the Managing Director of the Kogod Tax Policy Center (KTPC), which conducts non-partisan policy research on tax and compliance issues specific to small businesses and entrepreneurs. We develop and analyze solutions to tax-related problems faced by small businesses. Thank you for inviting me, and by extension, the AU undergraduate students in my Federal Income Taxation class who are here with us today, to talk about expanding opportunities for small businesses through the tax code.

The U.S. Senate Committee on Small Business and Entrepreneurship (the "Committee" or "SBC") has a long history, dating back to its days as a select Senate committee, of working on behalf of America's small businesses on tax issues. Beginning in 1953, this Committee prepared a comprehensive survey of the impact of federal taxes on small businesses, culminating in an annual report to the Senate with key recommendations. Since then, the SBC has held more than 40 hearings over the years on tax-related concerns of small businesses. I should know—prior to joining AU's faculty, I served on the staff of this Committee, from 2009-2014, ultimately as Chief Counsel. Before public service, I worked in private practice in Washington D.C. as a tax attorney with both PaulHastings and PwC's Washington National Tax Services.

However, it was my work on this Committee that led to me to conduct ground-breaking research at American University, which we published in June 2017 in a report titled, *Billion Dollar Blind Spot – How the U.S. Tax Code's Small Business Tax Expenditures Impact Women Business Owners ("Billion Dollar Blind Spot").*[1] There is no question that "[t]axation plays a key role in the survival and growth of small businesses, primarily through its effect on equity infusion. The major source of equity capital for expansion of a business is reinvested profits. The amount tax the business must pay

[1] Bruckner, C.L. (2017). *Billion Dollar Blind Spot: How the U.S. Tax Code's Small Business Expenditures Impact Women Business Owners*. Kogod Tax Policy Center Report, *available at* https://www.american.edu/kogod/research/upload/blind_spot_accessible.pdf.

determines the amount of money available for growth and expansion."[2] In addition, it's a fact that 99% women-owned firms are small businesses, according to SBA's Office of Advocacy's latest report on women-owned firms.[3] These two facts inspired our trailblazing research in *Billion Dollar Blind Spot* to study for the first-time ever whether the small business tax incentives included in the tax code created opportunities for women-owned firms to access capital.

Existing research by academics generally, and this Committee in particular, has consistently found that women business owners struggle to access capital to grow and scale their businesses. In 2014, under the leadership of its then Chair, Sen. Maria Cantwell, this Committee issued a report finding that access to capital is a more severe challenge for women-owned firms and that women only account for 16 percent of conventional small business loans, and 17 percent of SBA loans; which means just $1 of every $23 in conventional small business loans goes to a women-owned business.[4] More recently, last year Sen. Shaheen issued a report detailing what women entrepreneurs need to thrive that concluded, in relevant part, "women entrepreneurs are unable to access their fair share of financial capital, diminishing their chances for growth."[5] At the same time, Congress, and this Committee in particular, has worked tirelessly to enhance the U.S. tax code to aid small businesses. Small businesses have regularly testified and requested Congressional intervention to facilitate access to capital, which is a common complaint among these firms. It's not unique to women-owned firms, just more acute.

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[2] INTERAGENCY TASK FORCE ON WOMEN BUSINESS OWNERS, THE BOTTOM LINE: UNEQUAL ENTERPRISE IN AMERICA. (U.S. Department of Commerce) (1978).

[3] Michael J. McManus, *Issue Brief Number 13: Women's Business Ownership: Data from the 2012 Survey of Business Owners,* Office of Advocacy, U.S. Small Business Administration (May 31, 2017), *available at* https://www.sba.gov/sites/default/files/advocacy/Womens-Business-Ownership-in-the-US.pdf.

[4] Majority Report of the U.S. Senate Committee on Small Business and Entrepreneurship, 21ST CENTURY BARRIERS TO WOMEN'S ENTREPRENEURSHIP (2014), https://www.sbc.senate.gov/public/_cache/files/3/f/3f954386-f16b-48d2-86ad-698a75e33cc4/F74C2CA266014842F8A3D86C3AB619BA.21st-century-barriers-to-women-s-entrepreneurship-revised-ed.-v.1.pdf.

[5] Report by SBC Ranking Member Jeanne Shaheen, TACKLING THE GENDER GAP: WHAT WOMEN ENTREPRENEURS NEED TO THRIVE (2017), https://www.sbc.senate.gov/public/_cache/files/2/5/25bd7ee9-a37b-4d2b-a91a-8b1ad6f5bd58/536DC6E705BBAD3B555BFA4B60DEA025.sbc-tackling-the-gender-gap.december-2017-final.pdf.

As part of our research in *Billion Dollar Blind Spot*, we detailed the legislative history and Congress' intent to provide access to capital and opportunities for growth to small businesses with respect to four specific tax expenditures (i.e., IRC §1202 – *100% Exclusion from Capital Gains Tax for Investments in Qualified Small Business Stock*; IRC §1244 - *Ordinary Loss Treatment for Investments in Small Business Stock*; IRC §179- *Expensing for Small Businesses*; and IRC §195 – *Deduction for Qualified Start-Up Costs*). Each small business tax expenditure we studied met two criteria:

1. Congress intended the provision to stimulate growth or access to capital or investment in smaller firms; and
2. Each expenditures generated a cost to U.S. taxpayers of at least $100 million.[6]

Ultimately, *Billion Dollar Blind Spot* raised questions as to (i) whether the U.S. tax code's small business tax expenditures were operating as Congress intended to provide access to capital to these small businesses; and (ii) whether the cost of these expenditures had been accounted for in terms of their uptake by women-owned firms.

Our research is particularly relevant in today's economy because although women business owners account for 40% of all U.S. firms and the total number of women-owned firms has increased over the last ten years by 58%, women business owners remain small businesses primarily operating as service firms (more than 60%) and continue to have challenges growing receipts and accessing capital.[7] Women of color are leading this charge and are the "driving force behind the growth of women-owned firms."[8] Firms owned by women of color grew at a rate of 163% during the last 10 years and today, women of color own 64% of the new women-owned businesses launched each day.[9]

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[6] *Billion Dollar Blind Spot*, *supra* n. 1 at 7 (noting revenue loss are a key factor in Congress relies on in determining the effectiveness of a tax expenditure).

[7] The 2018 State of Women-Owned Businesses Report, Venturer (2018), *available at* https://about.americanexpress.com/files/doc_library/file/2018-state-of-women-owned-businesses-report.pdf.

[8] *Id.*

[9] *Id.*

Despite this extraordinary growth, there has been no formal government or Congressional accounting as to whether small business tax expenditures targeted to help small business access capital impact are distributed to women-owned firms. Our report is the first effort to assess how the U.S. tax code's more than $275 billion of tax expenditures targeted to help small businesses grow and access capital impact women-owned firms.[10] Specifically, we found:

- Three of the four small business tax expenditures (i.e., IRC §1202, §1244, and §179) we assessed are so limited in design that they either (i) explicitly exclude service firms (e.g., IRC §1202), and by extension, the majority of women-owned firms; or (ii) could effectively bypass women-owned firms who are not incorporated (IRC §1244) or who are service firms with few capital-intensive equipment investments altogether (IRC §179).
- Our survey data of 515 experienced, engaged women business owners corroborates these findings, and nevertheless suggests that when women-owned firms can take advantage of tax breaks, they do (IRC §195). However, neither Congress nor Treasury or IRS or SBA has ever measured how the tax code's small business expenditures impact women business owners.[11]

[10] Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2017-2021, JCX-34-18 (May 25, 2018), *available at* https://www.jct.gov/publications.html?func=startdown&id=5095. The revenue loss estimates included in this testimony reflect JCT's latest revenue estimates as set forth in JCX-34-18, which include changes attributable to tax legislation through February 2018.

[11] *Billion Dollar Blind Spot*, supra n. 1. As part of our research, we conducted a survey of the members of Women Impacting Public Policy (WIPP) and its coalition partners. Our survey was designed to gauge whether and how familiar self-identified women business owners are with the Code sections we identified for review and whether those women-owned firms accessed them. Our intention in conducting the survey was not to prepare a statistically reliable estimate of the entire American population of women-owned firms, or even of the more than one million WIPP and their coalition partner members, but rather to gauge whether engaged, experienced women business owners, defined by their own self-selection as members of WIPP or one of its coalition partners, are familiar with and take advantage of specific tax incentives that Congress has targeted to small businesses. WIPP and its coalition partners invited their memberships to participate in the online Survey Monkey survey, which was conducted from March 9, 2017 through April 11, 2017. We received 515 completed responses from women who, on their own, or with other women, owned at least 51% of a business, from the more than 550,000 WIPP or coalition partner members invited to participate in the survey.

Our research results suggest the immediate need for Congress to conduct oversight and due a formal accounting for how existing tax expenditures create opportunities for women-business owners to access capital.

- For example, Congress designed IRC §1202, which allows angel investors to invest in qualified small business corporations, to explicitly exclude service firms. Our research found that this limitation has resulted in only a very small minority of women business owners being able to utilize it. In fact, we identified only three women business owners who had ever used IRC §1202 to raise capital for their business. Keep in mind, this is a $6.5 billion tax break developed by the former Chair of this Committee, Dale Bumpers, to raise capital for small firms. While we expect that more than three women-owned firms have used this provision since 1993, we don't have publicly-available IRS or Treasury taxpayer data to prove it.
- Similarly, with respect to IRC §179, our survey results found that women business owners claimed this tax break at significantly lower rates (47%) than existing government research finds for businesses generally (60% to 80%). This tax break is one of the more expensive small business tax incentives (i.e., it will cost taxpayers $64.5 billion from 2017-2021), and yet we don't have any IRS or Congressional research on how it benefits women business owners, and what research we do have suggests that women business owners benefit less than business generally from one of the largest small business tax incentives.

Our research shows that Congress and stakeholders have a billion dollar blind spot when it comes to understanding how effective small business tax expenditures are with respect to women-owned firms. This blind spot indicates Congress does not have data or research to make evidence-based tax policy decisions to expand opportunities for 40% of all U.S. firms to access capital through the tax code. In addition, our research suggests that Congress may have doubled-down its billion dollar blind spot in the most recent overhaul of the tax code, the *Tax Cuts and Jobs Act of 2017* (P.L. 115-97) (TCJA).

In particular, our initial assessment of two of the key tax investments of the TCJA (§199 and §179), which were designed based on two of the small business tax incentives we studied (§1202 and §179), confirms that questions we raised in *Billion Dollar Blind Spot* were not robustly investigated in connection with Congress' efforts on tax reform. Instead, Congress made additional investments in small business tax expenditures that our research suggests are less favorable to women business owners in terms of distribution of tax benefits, which the Joint Committee on Taxation's (JCT) April 2018 distributional analysis seems to confirm.

For example, according to Table 3 of JCT's distributional analysis of the TCJA, more than 90% of the revenue loss generated from the new pass through deduction under IRC §199A will flow to firms with income of more than $100,000 in 2018 and 2024.[12] However, the most recent data available finds that 88% (or 10,775,600) of women business owners generate revenues less than $100,000.[13]

This inequitable distribution is even more pronounced when considered at higher income levels: only 1.7% of women-business owners have receipts of $1,000,000 or more, but JCT found in 2018, 44% of the IRC §199A revenue loss will flow to pass-through businesses with $1,000,000 of income. Moreover, JCT projects that the 44% revenue loss distribution will increase to 52% by 2024.[14] While many women business owners will no doubt see some benefit from IRC §199A, JCT's distributional analysis raises serious questions as to the equity of the distribution of the tax expenditure with respect to women-owned firms. In addition to concerns regarding the distribution of the revenue loss generated by IRC §199A, our research suggests additional oversight and tax research is warranted with respect to the TCJA's investments into expanding IRC §179.

[12] Joint Committee on Taxation, Tables Related to the Federal System as in Effect 2017 through 2026 (JCX-32R-18), April 24, 2018. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[13] The 2018 State of Women-Owned Businesses Report, *supra* n. 7.

[14] JCT, *supra* n. 12 at Table 3.

Congress doesn't know whether the money it has spent trying to help smaller firms access capital and grow has been well spent with respect to women-owned firms. The absence of research on these issues is contrary to recent Congressional efforts to engage in evidenced-based policy making going forward and means Congress does not have adequate data to understand whether the more than $275 billion in tax incentives it has enacted already create opportunities to access capital for more than 12 million small businesses or 40% of all U.S. firms.

This Committee should be congratulated on holding this hearing and immediately set to work to develop the needed research to understand how and whether existing tax incentives create opportunities for women-owned firms to access capital. That noted, the existing lack of tax research and effective Congressional oversight on how tax expenditures impact women business owners constrains policymakers from developing evidenced-based policymaking on creating opportunities for small businesses through the tax code.

As next steps, we recommend the Committee employ the following strategies to develop necessary research on these issues including:

1. Requesting the Congressional tax-writing committees hold joint hearings together with this Committee on the small business tax issues identified in *Billion Dollar Blind Spot* and this testimony; and
2. Requesting the Joint Committee on Taxation develop estimates on how small business expenditures impact women-owned firms in terms of the revenue loss distribution.

We stand ready to aid the Committee in this important work on behalf of the millions of small businesses impacted by these issues.

Senator RUBIO. That was incredibly impressive.

[Laughter.]

We are going to have a vote in a few minutes. I am not going to leave. We are going to keep this train running.

So let me defer to the Ranking Member so he can go vote, and then we will figure it out from there.

Senator CARDIN. We apologize about a vote being scheduled at 3:15. We do not apologize for the vote because it is opioid legislation, which is strongly supported on a bipartisan basis, but we will have to go out to vote and come back.

Senator RUBIO. Actually, I am still waiting for my alert on this phone. I did not get it on this phone.

[Laughter.]

So if anyone is listening, it malfunctioned on this one.

Senator CARDIN. I do not think it started yet, the vote. It did? The alert? It came down.

Senator RUBIO. I did not mean to throw us off track. I apologize.

Senator CARDIN. Again, thank all of you for your testimony.

I think I want to start on the targeting of the tax bill. The numbers that you have given us on the $415 billion in regards to the 199A—I know there are other provisions that affect small businesses that are in the bill, but that was the largest single-dollar number, was the pass-through deduction, Section 199A.

And it is kind of shocking, the numbers that you are giving us, as to the number of women-owned businesses, minority-owned businesses. The amount of the $415 billion received by those businesses is going to be kind of small.

So if you have $415 billion in the Tax Code, where is the best place for us to use it to really reach those small businesses that need attention in our system?

Ms. BRUCKNER. I think that the first thing that you need to consider when you are assessing effectiveness of tax expenditures to give access to capital to small businesses is that you cannot limit it by industry or by income.

So when you design tax incentives that are specific to manufacturing or construction or capital-intensive expensing, what you are doing is bypassing the majority of women-owned firms who are in services that do not have those expenses that are underrepresented in those industries, and the fact is women business owners are where the growth is with respect to small businesses in general. They have grown at a rate of over 58 percent, which is well in excess of the average over the last 10 years.

Senator CARDIN. Yes, sir.

Mr. ARENSMEYER. Senator, I think if you are deciding how to spend $415 billion, that is a lot of money. I mean, we were not actually in favor of an unpaid-for cut, to begin with, just because we have a fairly robust economy, and it weakens the ability of the Government to take steps when we do not have as robust an economy.

That said——

Senator CARDIN. Let me put this in a different way, so you understand. I think that was added to try to develop some degree of justification that smaller companies have tools in this bill.

I agree completely with you that it should not have been unpaid for. The whole bill should have been paid for.

But if we had that amount of relief coming to small businesses, how can we better target?

Mr. ARENSMEYER. Well, I mean, right now, the numbers speak for themselves. You can just do the math. The combination of the amount of income of the very small number of large pass-through entities and the marginal rate being much higher means you get a very skewed distribution that does not really impact Main Street businesses.

So we have proposed—and, again, our proposal is just an idea—flip it around. Do it from the bottom up. Give the biggest tax break to the people at the bottom, and you do that by giving kind of a fixed amount. Phase it out at a certain point. We are not wedded to that. There are other ways to do it.

I think you have to look at where is the money going, who is benefiting from the money, and figure out is that really where you want to put the biggest bang for the buck.

Senator CARDIN. Thank you.

Mr. Lettieri, I want to talk about Opportunity Zones. I support Opportunity Zones, so let me just qualify that. And I thank Senator Scott and Senator Booker for their leadership in getting that into the tax bill.

But I am concerned as we look at well-intended tax provisions, Puerto Rico, for example, in which I think most of us would say that we could have done a better job in the tax break we had in Puerto Rico. The benefactors of the tax break are going to be investors. We want the investors to invest in underserved areas and in longer-term investments. I get that, but the profits could very well be taken out of the community and invested anywhere the investor wants to invest it.

What lessons have we learned from the past so that as we implement these Opportunity Zones, we really get permanent commitments to underserved communities?

Mr. LETTIERI. Well, Senator, thanks for the question.

It is important to understand that Opportunity Zones are an equity incentive, and so there is an exchange of wealth happening as part of that investment to a business owner. Unlike a debt investment, which satisfies a different set of needs, equity is key to growth for growth businesses. It is also important to the business owner in terms of what it provides them as a wealth event in addition to a chance to grow their business. So——

Senator CARDIN. But I understand that the tax incentive is lower tax rates on the——

Mr. LETTIERI. It is. It is a capital gains incentive to the investor as to effectuate a change in behavior, but what they have to do in order to get that incentive is to invest equity in a business or business property within the target areas. And by definition within the statute, the incentive skews very heavily towards small and new businesses, ones that are poised for growth.

So I think that alone helps to address some of the scoping concerns because of the way it is designed. There is not the same type of potential for either misdirected incentive dollars or the kind of

leakage that you see going to larger corporations that have maybe a toe in the designated area but not truly are of those areas.

Senator CARDIN. I would just underscore if we do not get it right from the beginning, there is going to be a missed opportunity for the full benefit.

I thought your testimony was pretty clear about that, and I appreciate your testimony. I would just urge all of us to stay focused on how this is implemented to make sure we do not end up, 10 or 15 years from now, in the same situation and wonder where the money went.

Mr. LETTIERI. I agree.

If I could just add one other thing to that, I think Opportunity Zones reflect a lot of the concerns about the limitations of policies of the past, and that was baked into the design, both in the long-term nature but also to Ms. Bruckner's point, the intended flexibility of the incentive, not dividing it by sector, because complexity is subsidy to larger interests when it comes to the Tax Code. So the more simple and straightforward you can make it, the easier the uptake is going to be among smaller and newer businesses.

And that is one of the things we have seen as a failure in previous programs, where the business owners themselves said the complexity was a factor in whether or not they used it.

Senator CARDIN. There is no question. Complexity for small businesses is critical. They do not have staff to handle complexity, and I would just urge we get back one more time to 199A.

I have heard real complaints from small companies as to the complexity of the 199A calculations, let alone the fact that it is not permanent.

So I think you are absolutely right, and I am glad it is broader in that scope.

Thank you, Mr. Chairman.

Senator RUBIO. Thank you.

I am going to defer my time.

Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman and Ranking Member. I appreciate this opportunity.

I used to have a retail shoe store, which was a small business, and so have had a focus on small businesses. Also, I try to get back to Wyoming pretty much every weekend, and when I am traveling, I like to get into some businesses, usually businesses that I am not familiar with, because one of the things that I have found is that any business that I am not familiar with looks pretty simple until I see what kind of decisions they have to make—how do they get their employees, how do they train their employees, how do they advertise, how do they get their customers, how do they treat their customers.

Small business definitely has a tough road because they cannot afford the expertise that the big companies can afford.

The tax bill, of course, was focused on economic opportunity, and some of the biggest opportunities are with some of the biggest companies, and a lot of that was repatriating money from overseas so that it could be invested in the United States. And I am hoping that some of that will be invested in small companies.

I would report, though, that in spite of the tax cut, revenues this year are up $19 billion over last year, which is above the year before, and that is without the September estimated taxes, which is usually the biggest tax receipt month, other than April. That would be the biggest tax month resulting from this.

And when we talk about a hundred—a trillion-and-a-half deficit, you have got to remember that that was specified that it would be static scoring. Static scoring means that the CBO when they were evaluating this had to ignore any effect that the bill would have. Then economists told us that if we could have at least 2.4 percent GDP, this would be paid off over a 10-year period.

Now, I mentioned the $19 billion ahead in expenditures this year were $240 billion ahead. So the deficit does not just come from the tax cut. In fact, the tax cut is doing pretty well, but it is still spending.

Now, Ms. Slaughter, the NFIB recently—the National Federation of Independent Business—showed that a majority of small businesses are optimistic about the effects of the tax reform.

Let me mention some of their findings. Eighty-seven percent of the member businesses—these are independent businesses, small businesses. Eighty-seven percent of the member businesses believe the new tax law will have a positive effect on the economy. Seventy-five percent believe it will positively affect their business, and 70 percent anticipate the new tax law will positively affect their personal tax situation.

Given the broad range of small businesses represented by the U.S. Chamber Small Business Council, what are you hearing from members about being easier to invest, to hire, to grow after the tax reform? Are there particular elements of the tax reform, whether for individual owners or businesses, that have helped the most?

Ms. SLAUGHTER. Thank you very much, Senator.

Let me try and address some of your questions.

Yes, I think that there are a number of examples that are both general in nature and specific in nature.

The most frequent comment that I heard from my clients in preparing for this hearing today was that the reinvestment was put into wages and employee benefits. Now, that is not a scientific data point at all. That is strictly anecdotal from my experience.

Everything from the employer paying more of the proportion of the employee health care cost to adding additional benefits—Roy O. Martin, for example, has added benefits, paying more of the employee cost, and has also put a pharmacist on their staff to help reduce the cost of prescriptions.

Senator ENZI. Thank you.

Ms. SLAUGHTER. So we are hearing a lot of those things.

Senator ENZI. My time is pretty limited. So I will ask in writing for each of you to answer that question.

But I want to ask one question on Opportunity Zones. Mr. Lettieri, can you mention some ways that we can evaluate and track the success of Opportunity Zones?

We have got 32 of those zones in Wyoming, and it is largely rural, but I do not know what metrics to use to do that in populated or unpopulated areas.

And, again, I would be interested in all of your answers, but in 20 seconds, I am going to be out of time.

Mr. LETTIERI. Senator, thank you.

I think we are a data-driven organization, so more is better when it comes to analysis from our standpoint.

There are a few things that we can do. One is we have a great natural experiment. Only 25 percent of the eligible areas were chosen as Opportunity Zones, so we should look at their performance over a long period of time versus those that were not chosen and see what type of trajectory change we see as a result of the Opportunity Zone designation.

Opportunity Zones are going to have a different effect in different places based on local conditions. It is a very localized, decentralized incentive policy, and so we also have to look at what are the local communities doing in terms of their local policy and regulatory efforts and their practical support to administer Opportunity Zones and enhance the value of the capital coming in for those who actually live in the community.

I think with those two measures, looking broadly at the performance of the selected zones versus those that were eligible and not selected, taking a careful look at best practices at the local level to understand what has worked and not worked as well in terms of the State and local side of this.

And then, third, we already know today the number of businesses and jobs that exist in Opportunity Zones as a starting point. That is a very easy benchmark to say over time how well do these places do over the next 10 to 15 years of adding to those two measures.

Senator ENZI. Thanks.

Again, I hope we can submit questions for everybody to answer.

Senator RUBIO. Senator Shaheen.

Senator SHAHEEN. Thank you, Mr. Chairman.

Thank you all for being here.

This question is really for every one of you. Last June, the Committee held a hearing on tax reform, and during that hearing, I read a statement from New Hampshire's 2017 Small Businessperson of the Year, who also happens to be the CEO of a company called Celdara Medical, which is a biomedical company in Lebanon, New Hampshire.

And what Jake said in that statement is that he wanted tax reform to help simplify the tax-filing process, and he said this is not about paying less taxes. This is about spending less time and energy on taxes and knowing that we are doing them right.

Now, in the last couple of weeks, we have heard from Jake again who says that tax compliance results in large amounts of distraction expense and wasted time, and that the tax law has not addressed his concern. And he says time is the most important resource that a small business has.

So what steps can we take in Congress, now that that tax law has already passed, on a bipartisan basis that can help make the tax-filing process simpler and less painful for small businesses? Because the tax bill did not do that.

So, Ms. Bruckner, do you want to go first?

Ms. BRUCKNER. So, Senator Shaheen, one of the key proposals that was included in the original Senate Finance Committee bill was a proposal to align the 1099–K, 1099–MISC filing requirements, and the way it stands now under current law is that most gig workers and independent contractors that are paid electronically, they do not hit the filing thresholds of $20,000 and 200 transactions to actually get the forms they need to file their taxes.

I did a survey on this and found only 32 percent of the people I surveyed got any 1099 at all. How in the world are you supposed to file your taxes if you are not getting any kind of form from the Government or notification that the IRS knows what you are up to? And that is a huge problem.

I am coming out with new research that actually estimates how much it costs in terms of Social Security, and my numbers are jaw-dropping. I will be happy to submit that to the Committee later.

Senator SHAHEEN. That would be helpful.

Mr. Arensmeyer.

Mr. ARENSMEYER. Yeah. I mean, I just want to quote from the bipartisan—I am sorry Senator Cardin is not here—Portman-Cardin Act that has a number of provisions in it that I believe have bipartisan support, a safe harbor for employer-only tip audits if the business fits certain educational and fits certain requirements, clarification on reporting requests about tip income, streamlining the S corporation process, establishment process, release of Federal tax liens on businesses if they have economic hardship, and other things like that.

I cannot believe these do not have bipartisan support.

Plus, what Caroline talked about on the alignment, also there is burdensome quarterly tax filings for freelance employees. We may be able to go to annual on that.

Establishing a standard business deduction for independent workers, this is a little bit more out there, but there is a lot of talk about just the way we do for individuals, set a standard business deduction. You do not have to take it. If you want to get all those receipts in a shoe box and count them up, you can do that, but in fact, if you do not want to, you just kind of—we come up with a number, and we allow them to do standard deduction.

So there are a number of things that can be done, none of which—all of the ones that Caroline and I talked about, I cannot believe would not be fairly bipartisan.

Senator SHAHEEN. Mr. Lettieri.

Mr. LETTIERI. I guess I would add one new category of things we should think about because the compliance burden question is an important one.

We should be thinking about new businesses as a distinct subgroup of small businesses and think about how we can build a tax compliance regime for new businesses that allows an easier on ramp to viability.

Those first few years are incredibly challenging, and that is when businesses are most vulnerable. That is when that precious time resource is the scarcest, and so if we think about the Tax Code even outside of the dollars and cents, incentivizing entrepreneurship by easing the on ramp to compliance, I think that would be a really effective thing for this Committee to take on.

Senator SHAHEEN. Thank you.

Dr. Slaughter.

Ms. SLAUGHTER. Thank you, Senator.

I would echo what your Small Business Award winner said. Time is a great challenge to a small business owner, especially very small businesses.

I think that one of my clients has 200 CPAs. They are trying desperately to get information out to their small business clients. They find that whether it is sent in an email or a newsletter or whether they are holding seminars to try and educate them, there is too much noise out there. So small business owners, we do not think have even realized the possibilities and the extent of how they might benefit from the tax cuts, and they will not until they go through this first cycle since the IRS guidelines are still sort of coming out in some areas.

So I think anything that Congress can do to help get information out, communicate and simplify, would be wonderful.

Senator SHAHEEN. So you are not actually suggesting a simplification. You are suggesting that what we need to do is ask the SBA to provide information about tax filing?

Ms. SLAUGHTER. I think both would be tremendously helpful. All simplification is good. I would echo what the panel has said. It is very, very important.

Senator SHAHEEN. Thank you.

Thank you, Mr. Chairman.

Senator RUBIO. Thank you.

Senator Young.

Senator YOUNG. Well, thank you, Mr. Chairman. This is a timely hearing.

As I travel around the State of Indiana, I just encounter countless businesses that are enjoying the impact of tax reform in a very positive way, and it is important, however, that we continue to optimize the Tax Code. My hope would be that we do not wait another 31 years before we fix whatever, moving forward, are deficiencies in the Code.

In Indiana, we are really excited, as I know some of the other States are, about this Opportunity Zone designation, and I commend you, Mr. Lettieri, as well as your organization, on conceiving of the concept and working with Senator Scott to help champion it and get it into law.

We have 156 Census tracts that have been designated and certified as Opportunity Zones. I would associate myself with everything Mr. Enzi asked about with respect to reporting requirements and tracking. If there is anything we can do statutorily or need to do moving forward, I hope you will work with this Committee, members of this Committee on that. I am very interested in measuring success, as I know you are.

What recommendations do you have, Mr. Lettieri, for localities and States to maximize investments in these designated zones?

Mr. LETTIERI. Thanks for that question, Senator Young.

I think it is important to start with the recognition that an Opportunity Zone designation is not a guarantee. This is not a grant program. It is not a tax credit allocation.

And that on the community side, one of the things we have tried to work very hard at educating folks on is they have to do something to prepare. This is not just going to happen to them by default. So what does that mean? That means that on the local level, you need to be proactive at working with the different stakeholder groups that can build a strategy for what these Opportunity Zones in a given community are going to look like. There is not a national answer to that question. There is a local answer to that question, though, so taking a proactive approach.

I thought Indiana did a fantastic job with their selection process, which really sets up the next step. They involved a lot of local stakeholders. They did it in a fairly transparent way. The governor has his selections reviewed by an outside board of stakeholders. That was impressive to us, and I think it shows a real forward-leaning momentum.

But this should be deployed as part of a broader strategy. Capital is one of the challenges these communities face. It is not the only challenge. So this will be a much more effective incentive tool if it is part of a broader framework that includes workforce training and all kinds of other issues.

Senator YOUNG. Thank you.

I have launched an agenda, as I travel around the State of Indiana. We call it our Fair Shot Agenda, making sure that every Hoosier and really every American has a fair shot of success, and we leave it up to the individual person to define success. We just want to remove barriers, and where appropriate, make sure that Government is a catalyst so that people can realize their dreams.

One centerpiece of that overall agenda focuses on addressing heat gaps in workforce training, including through apprenticeship programs and career and technical education.

How in your mind might Opportunity Zones be integrated in broader efforts that aim to address barriers to upward mobility and specifically perhaps integrated with respect to some of these workforce training issues?

Mr. LETTIERI. Well, I think, again, to the earlier question, having a workforce-focused approach that runs in parallel to the capital-focused approach of Opportunity Zones is really critical.

One of the things we see as we do research about distressed areas nationwide, it is one of the strongest and clearest fault lines between prosper in communities and those that are not, is an education and training gap. So we have to equalize that playing field in a better way for the capital and the opportunity to flow.

One smart approach locally is going to integrate workforce training oriented towards the types of businesses and investments that you are likely to see through Opportunity Zones, so that local residents can actually benefit from this and be integrated in as new opportunities open up.

Senator YOUNG. Can you discuss what steps must be taken to facilitate the greatest amount of investment in Opportunity Zones across Indiana and the U.S.? Maybe you have something to add to what you have already said which—and I think you have been really clear, and it is my sense of the construct here. It is really up to the localities to ensure that they are as fertile ground as they can be, as attractive investments as they can be for would-be inves-

tors—you have just changed the hurdle rate for given investments, you meaning your organization working with Congress and this President in establishing these Opportunity Zones.

But are there other steps that we can take to facilitate a maximum amount of investment in Opportunity Zones?

Mr. LETTIERI. Both in terms of amount and type, I think we are at half time right now. Half time was getting the bill passed and seeing that first phase of implementation and the zone designation.

It is not a guarantee that the implementation process, the regulatory rulemaking will follow through to the full potential, and I do not say that in an ominous way. I say that is an open question. We know, based on past precedent, that most Federal policies aimed at these very same types of outcomes have fallen short in the rearview mirror of the types of goals that we all would hope to see.

So the rulemaking has to be very intentional to avoid those same missteps, particularly in the space of operating business investment. That is the core, the beating heart of Opportunity Zones, if it is going to succeed. It is because it draws capital into new and small businesses that are poised for growth.

So if the rules are oriented in that direction, the capital is not going to be a problem. There is tremendous interest. There is tremendous potential, and I think we are falling well below our potential as a country in terms of matching capital to opportunity around the country.

But the rulemaking is going to be key. That is the first question every investor is asking. It is the question that is going to be determinative of which businesses qualify. If we do not get that right on the front end, I think to Senator Cardin's point earlier, it is very hard for a local community to do everything right. They may still be stymied at the end.

Senator YOUNG. Well, we will be watching implementation closely and helping however we can, I know in a bipartisan way, so thank you.

Senator RUBIO. Thank you.

Senator Heitkamp.

Senator HEITKAMP. Thank you, Mr. Chairman.

I want to just talk a little bit about the new economy and about the challenges you have. I just want to remark that a 1099 is not a Government form. It is authorized and mandated by the Government. But to go back and take a look at the Affordable Care Act, actually expanded 1099 requirements, and it was an abysmal failure because, all of a sudden, no one knew. People who were legitimate businesses were having to file so many of these things that it added burden onto those small businesses. So I think we are challenged.

I am intrigued by some kind of standard deduction. The Schedule C-EZ has a mechanism for like a standard deduction. Can someone comment on that? Does not the Schedule C-EZ basically give us a vehicle to do a standard deduction for small business?

Mr. ARENSMEYER. Well, I think what we are suggesting is you would have a standard deduction on the business, on the business income. It would be a different amount than the standard.

You are talking about the individual standard deduction——

Senator HEITKAMP. Right. I am talking about——

Mr. ARENSMEYER [continuing]. Instead of taking mortgage or charitable? This would mean instead of taking business expenses.

Senator HEITKAMP. Well, that is part of the complicating features, which is that if you are a sole proprietorship, you are going to file a Schedule C. If you are organized under some kind of limited partnership or under some kind of Subchapter S, you are going to have a whole lot more paperwork. And you could find some mechanism to transfer that C-EZ form into your K-1's, whatever you want to look at, when you are looking at a Subchapter S filing.

But one of the complicating features is we are doing business in different kinds of mechanisms and under different kinds of business structures. So when we look at this, we can say, "Look, why do we require thousands of dollars of recordkeeping if your tax liability is going to be less than $2,000?" It is ridiculous.

So I think we all have an idea of where we would draw that line and basically say we are going to make it a presumption. You do not have to keep any records. You do not have to worry ever about—as long as you have the total gross income right, you do not ever have to worry about an audit because we have got your back on this.

And it seems to me that that is attractive, but it also does not get us in that spot where our small businesses are really doing the kind of recordkeeping they need to do to identify how profitable they are. And so those tax mandates tend to drive that small business person out.

I will give you a "for instance." I used to be the tax commissioner in North Dakota, and I would find someone who could take the most crumpled up car and put it back exactly the way it was, had absolutely no interest in business, but could—greatest body man in the world, right?

So we have got to figure out how we can provide the tools for someone who is entrepreneurial like that to actually feel comfortable filing tax returns, and I think some of these shortcuts and mechanisms are valuable. And I am very interested in unique ideas, recognizing that not everybody does business as a sole proprietor.

Now, with that said, I would also say that I think when you—for all of the discussion we have had about tax reform, my small businesses are coming and saying there is no certainty to this for us. You have given certainty to the C corps, but you have not given certainty to the S corps. You have not given certainty to the limited liability partnerships. So how do I now do long-term planning on investment if I am operating under that legal structure for my business?

So I think we need to have a real conversation about how do we provide that certainty going forward to these smaller businesses that are operating not as C corporations. I mean, it is a huge percentage of North Dakota businesses are Sub S's or they are limited liability partnerships or they are even sole proprietorships. So that is going to come with a price tag.

But it seems to me that the role of this Committee is really one of advocacy. I mean, a couple members here are on the Finance Committee, but to me, their job is to make it all work and to make

the system equitable and not be that advocate for the truly small business that we want to help.

So I want to thank the Chairman and the Ranking Member for putting this together. I think it is really important that we have those discussions about where we have failed small business in terms of predictability under this Tax Code and how we can expand their opportunities, but I think we also need—with all due respect, I do not think that this Tax Code simplified anything.

I mean, if I were writing something, it would not be this if I wanted to simplify it.

So let us keep believing that we can do a better job with the Tax Code.

Thank you, Mr. Chairman.

Senator RUBIO. Thank you.

So I am going to ask my questions now as I await for my colleagues to return at some point, and then I will leave and go vote and come back. But I have questions, and I want to make sure I ask them because I believe we have exhausted—well, there is nobody here. So I think we have exhausted the questions.

[Laughter.]

I know you are here, but you already asked your questions. So I know you may have a follow-up.

Let me just start. My concern—I am a big fan of the Opportunity Zone concept, and I believe it gives an extraordinary opportunity to sort of create, in communities that have been forgotten in America, some of the same benefits that have driven investment overseas. People have gone overseas to make their investments because they have better tax treatment or they found labor costs or whatever it might be, and I think we can create the same competitive advantage here in distressed communities.

The concern is always that in the end, the communities themselves may be the site of the investment, but not the beneficiaries of the investment.

So I would just ask everybody on the panel. What needs to be done, or what are the markers that we need to be looking for, whether it is through local government or anything we can do from here, to ensure that the local community, where the investment is going into, is also the beneficiary of that new investment? Because you can open up a new facility somewhere but not necessarily help the people who live in that area and have been left behind. So what are the sorts of things that would help ensure that the locations of these investments also happen to benefit from them?

Ms. BRUCKNER. One of the things that you can do—and I have a little bit of experience with comparable instruments because of the GO Zone, the Gulf Opportunity Zone Act, which was passed as part of rebuilding Louisiana in the wake of Hurricane Katrina.

And one of the things that we did not do enough of was appropriate oversight from Treasury and developing metrics that communities had to hit in terms of economic activity.

Now, of course, that can be challenging, and it is not like a one-size-fits-all standard, but aspirational or specific metrics that are recorded and tracked by Treasury could be one way that you could have appropriate oversight that is not too cumbersome and yet still be able to fundamentally identify whether or not what you are

doing is working and if your investment is really benefiting the community.

Senator RUBIO. Anyone else have a suggestion?

Mr. LETTIERI. Great question, tough question, because there is more than a Federal role to play. In fact, I would argue once the regulations are done, there is mostly a State and local role to play in ensuring the local benefit. Because this is a tool, not truly a program, it is not an up-front allocation. It is not a tax credit, not a distribution of a scarce resource like a grant or a tax credit. So there is a fundamentally different construct here that requires the local community to really opt into a strategy.

And so because of the nature of the investment being a long-term—it is a long-term incentive tied to capital gains. It puts the investor on the same side of the equation as the business they are investing in. If you have equity stake in a business and you have to wait a very long time to realize any kind of tax benefit, you also run the risk of losing money on that investment.

So I think that starts in the right place in terms of putting the investor on the same side as the business they are investing in, but it also requires a long-term strategy from the communities themselves in order to ensure that their particular local needs and conditions are being accounted for in the deployment of this specific tool. It is just a tool. It is not a strategy on its own. I think that is the bottom line.

Ms. SLAUGHTER. If I might add one point——

Chairman RISCH [presiding]. Please.

Ms. SLAUGHTER. I know that Senator Rubio had to leave for the vote, but I think this is very important. And I also, like Ms. Bruckner, had the opportunity to observe good use of Go Zone opportunities and things that maybe could have been rearranged a little bit or better focused.

I do think that local chambers of commerce, just as you described in Indiana, where the governor went out and worked with grassroots organizations to define and went through a process—I think that is what it is going to take. I am not sure that you can make that happen, but I think that by asking for metrics and oversight, you ought to get those kinds of things.

I do think that the U.S. Chamber can play a role in that, and that would help.

Chairman RISCH. Thank you very much.

I want to thank all of you for coming, and in case you have not noticed, you have got a real Chairman now. So this is going to go a lot smoother from here on.

[Laughter.]

Senator Ernst.

Senator ERNST. Thank you, Mr. Chair, very much, and thanks to our witnesses for being here for this hearing.

Last year, Congress passed the Tax Cuts and Jobs Act in providing long overdue tax relief for individuals and businesses, and under the leadership of Governor Kim Reynolds, Iowa has followed suit by passing the largest tax cut in our State's history.

Tax reform is already providing a huge boost for Iowa small businesses allowing our job creators to grow and in return reward their employees, which is really great.

Recently, I talked to a woman who owns a trucking company and a warehousing company in Pella, Iowa, and because of the 100 percent bonus depreciation, her business will be able to purchase six new semis and spend millions of dollars upgrading their facility.

I also heard from the owner of Hamilton Redi-Mix, which is a family-owned small business in Jefferson, Iowa, and as a result of tax reform, they are providing $1,500 bonuses to their employees.

I know in Washington, D.C.-speak, $1,500 is not a lot of money. In Iowa, $1,500 is a lot of money for our employees.

Surveys show that small business optimism is at an all-time high, and while a record number of small business owners plan to create jobs and grow their businesses—and it is wonderful.

I am excited about it. I know our small businesses are excited about it in Iowa as well.

A question for Dr. Slaughter. While this law is a significant step in the right direction for our small businesses, there is still work left to be done. I think a number of folks have acknowledged that. As you mentioned in your testimony, we do need to make these tax cuts permanent. Can you talk more about the importance of making the individual income tax cuts permanent?

Ms. SLAUGHTER. Yes. Thank you, Senator.

I think that it was even mentioned a moment ago by one of your fellow Senators——

Senator ERNST. I am sure.

Ms. SLAUGHTER [continuing]. That the certainty or the lack thereof is really a problem for business planning, and so small business owners face all the challenges we have talked about—lack of access to capital—serious challenges in terms of competing for a talented workforce, et cetera.

To have the opportunity to be able to look forward in what seems to be an expanding economy and realize that I am willing to go to my lender, I am willing to try and access more capital, or I am willing to try and reinvest—we have a young woman who is up here for the opportunity to win a Dream Big Award this evening. She runs a child care business in Metairie, Louisiana, and she recently made a $50,000 loan to expand her business. And it is very, very hard for her to get settled on the fact that if one thing goes wrong, she has made a very bad strategic decision.

Small businesses can be working with millions and millions of dollars or $50,000, but I do think that when people feel more of a sense of certainty about what is going to happen going forward, they will continue to make those investments.

And just like you talked about in the capital equipment area, we have a client who is a big contractor with the petrochemical industry, and he is going to upgrade his entire equipment fleet, which is very significant, lots of heavy construction equipment.

I think that you will begin to see that. You will see those vendors and suppliers—the John Deeres, the Caterpillars of the world—who supply those pieces of equipment. It will trickle down and benefit everyone.

Senator ERNST. Well, and that is great. And, again, we are seeing the benefit in Iowa, and I know other States as well. And, hopefully, we can take that step and make those individual tax cuts permanent.

Mr. Lettieri, thank you very much for the idea of Opportunity Zones. I appreciate that very much.

In your testimony, you discussed these Opportunity Zones provisions, which we did have in the Tax Cuts and Jobs Act that will encourage investment in distressed communities. This was based on legislation introduced by Senator Scott, and I cosponsored that as well. I thought it was a tremendous idea.

Iowa has 62 different Opportunity Zones, and many of those are in rural communities that have seen stagnant economic growth, persistently high poverty rates, and a declining population. How can Opportunity Zones help reverse these trends that we are seeing in rural America in those distressed communities?

Mr. LETTIERI. Thank you, Senator. Thanks for your support for the Opportunity Zones legislation——

Senator ERNST. You bet.

Mr. LETTIERI [continuing]. Authored by Senators Scott and Booker, and actually, this Committee, quite a few members of this Committee were early and active supporters of that legislation.

We are already hearing anecdotally some of the best success stories coming out of rural America, which I think surprises some folks. When you think about where there is an opportunity to do heavier industry, agriculture, some larger-scale projects, a lot of those are Opportunity Zone Census tracts in rural communities.

You need to play to your local advantages, though. This gets back to the earlier question about what is the local role and how do you develop a template for success.

The capital piece of this gets a lot easier with Opportunity Zones because you have a group of equity investors now looking for opportunities in areas they might have otherwise overlooked, but on the recipient end, you need a community that is pulling together to really maximize those assets, those local advantages.

Some of the most dynamic and upwardly mobile places in this country are still rural America. There is no doubt that rural America has a lot to offer, but it takes a lot of intentionality to put this tool to use in the right way.

But, again, even early on, even pre-regulation, we are seeing some of the early success stories happening in rural America, particularly in the manufacturing and agriculture space.

Senator ERNST. Absolutely. And I thank you for that.

Again, aptly named because the opportunity that is being presented to constituents that I have that would not have had that opportunity otherwise. So thank you very much for that.

Thank you, Mr. Chair.

Chairman RISCH. Thank you, Senator.

Senator Booker.

Senator BOOKER. Mr. Chairman, thank you very much.

I am really proud of the work. In fact, I think of all the things I have accomplished in my 5 years, my very short 5 years in the Senate, the Opportunity Zone legislation I wrote with Senator Scott and with EIG is probably the most impactful thing that we have done to deal with the issue, one of the issues that drove me to run for the United States Senate, which was dealing with the high-poverty areas, dealing with the inadequate opportunities for folks who

are in low-income areas, whether they are rural or urban. And I am just really proud and grateful.

I just was talking to Tim—Senator Scott—on the floor about some of the technical fixes, which were some of the issues I want to bring up right now.

As Senator Scott and I were cosponsors on this Committee, obviously I just want to give a lot of great gratitude to Senator Ernst and Senator Young for their partnerships.

Our legislative intent was really clear in much, in keeping with the purpose of today's hearing, which is to bring private capital off the sidelines into high-impact investments, not just real estate, but also startups, also small businesses, new entrepreneurships into stressed communities because the insanity in our country is that most of the VC dollars, most of the investment capital in this country only goes to about three States. It is not equally distributed. But genius exists all over America. Great ideas exist all over America.

So, John, you laid out in your testimony what needs to happen on the regulatory side. Is it your view that these recommendations will help realize, better realize the legislative intent, to ensure that opportunity fund capital flows to startups, entrepreneurs, and other small businesses, not just real estate?

Mr. LETTIERI. Thank you, Senator Booker.

Absolutely. I think, again, we should be able to measure the success over time of Opportunity Zones to the extent it drives capital to new businesses and supports new business formation in overlooked areas.

We know the statistics. You mentioned some of them are dismal, not just in terms of where capital goes, but who receives that capital. And so we know it matters where you live, what you look like, who you know, a lot more than it should in this country. And we can do better using public policy to close those gaps.

I think that the danger that we are in now in terms of any time you have a new policy is that the path of least resistance is to take the most narrow and cautious approach, and that skews towards real estate-oriented investment for a very simple reason. Real estate does not get up and walk out of an Opportunity Zone, and you have a lot more predictability with where and how you can invest in a real estate project than you can in a new business or an operating business that is scaling.

If you are not intentional on the front end about designing a regulatory framework that is particularly inclusive of the needs of new and growing businesses, you are not going to hit the mark. You will not do it accidentally. You have to do it intentionally, and you have to bake that in on the front end.

So that is what we are encouraging the Administration to really focus on. I think there are definitely things they can do, and Treasury has wide authority to make sure that the connective tissue with the regulatory framework is oriented around your core congressional goal which, as you said, is business investment.

Senator BOOKER. I appreciate that.

And that really gives me another point. I know Senator Risch and I are watching this very closely. We may or may not retire from the Senate joined together in an entrepreneurial endeavor.

[Laughter.]

I do not want confirm or deny whether that is true or not.

Chairman RISCH. You can bring the capital.

Senator BOOKER. Yes, sir.

[Laughter.]

But the truth is one element of this that is really, really important is the data collection element, and Opportunity Zone markets cannot function efficiently without access to sort of basic transparent data about Opportunity Zone funds and their investments. Information about fund size, investment size, investment type, industry and location are standard and already collected by fund managers and could be reported at really little to no cost.

In addition, reporting about job creation and new business starts and other outcome metrics really was a part of the original bill. That was the intent of Senator Scott and I.

Most importantly, making the data available will move capital off the sidelines, but connecting investors about what is going on out there, connecting them to funds and allow local stakeholders to align their development strategies because you and I know how key that is for local leaders to be aligned in investment strategies and additional incentives with the opportunity fund capital.

So would Treasury—John, again, for you—would Treasury or the IRS adopting a set of impact measures to be reported to help the Opportunity Zone market function—would it help the Opportunity Zone markets function more efficiently and effectively?

Mr. LETTIERI. I think if effectively designed, then the answer is yes, and the tension is always between how much you collect and what kind of burden that places on the recipient and how much we need to be able to know in real time where investment is going and what type of scale of impact we are having.

I think there is a way to strike the right balance. I think the original bill, as you said, had some very basic measures that are collected already. If we can make that straightforward and simple at a Federal level, that is one tier of data collection that I think would be worth pursuing and considering.

There is also the State and local, which you all cannot mandate, but governors that we are talking to, mayors that we are talking to, we are encouraging them to be as transparent as possible at creating a platform where either by opting in or by attaching other types of carrots to the process, they would get more information and more clarity about what is happening in their local jurisdictions. That married to some broad Federal data, I think could be very effective over time.

Senator BOOKER. Thank you so much.

Mr. Chairman, thank you for the time.

Chairman RISCH. Senator Cardin.

Senator CARDIN. While I was out, I heard that you talked about the tax administration provisions that are being negotiated today between the House and the Senate that I think could really help small businesses, and I appreciate you mentioning that.

I would just hope that we would concentrate on that from now to the end of the year because I think that could get done.

There has been action in the House. There has been action in the Senate. We just have to come together, and many of those provisions could be very helpful to small businesses.

I would just urge us all to make that a priority. A lot of things we are talking about are going to be next-year issues because we are not going to have a major tax bill until next Congress.

I know the House has passed "Tax Reform 2.0," and I know we have pension issues we have to deal with. And, hopefully, in this Congress, we can get some of that done.

Ms. Slaughter, I want to ask you a question on where you see the priorities from the Chamber for small businesses. I have noticed over my 12 years that the frustrations of small businesses at different times have been different things ranked, and I would be curious as to what you hear most from small businesses as their greatest challenge, and how does the tax issues rate today as far as priority lists among small businesses?

Ms. SLAUGHTER. Senator, I could not agree with you more that it is a reactive sort of cycle, and an unmet need becomes the next top priority.

I will tell you that in these meetings today, we have been talking quite a lot in the Small Business Summit and Small Business Council meetings about workforce development issues and the lack of being able to find trained workers.

I think Tom Donohue opened yesterday with a figure of about 700,000 jobs for which there are no U.S. workers available to take them.

Small business will really bear the brunt of that. We cannot compete with the big boys who are able to pay more money. They absolutely have to have someone with a skilled craft—master electrician. They will cherry-pick people who were long-time employees and well trained by small business, and so I think that that is a rising priority.

In Louisiana, we have a lot of efforts in terms of dual enrollment and jumpstart. We have a big problem with a stigma against jobs that do not require a 4-year college degree, and we have a lack of awareness. We started a program called Louisiana Calling to try and help deal with just communicating, marketing, and making parents and students aware of those kinds of jobs.

So I think the private sector in partnership with public sector, local and regional, can help with some of those things, but I do think that you are going to hear a lot of new issues that come forward.

Senator CARDIN. I appreciate that. I hear that a lot also on workforce development issues. It is a tight market, particularly for small businesses. So it is something we might want to take a look at as to how we can help.

Ms. SLAUGHTER. Yes. And I think, actually, we are building somewhat of a conundrum here because the tax cuts, as I said, often will fall to the worker, the current workers, but also new businesses and new jobs. So the problem seems like it may get worse before it gets better.

Senator CARDIN. I want to ask Mr. Arensmeyer the issue. You have been the most vocal about your concern on the deficit, which I share, and we have also pointed out that the complexity issue is

made much worse because the temporary nature of the provisions that relate to small businesses, that relate to the individual taxpayer as compared to the C rate and some of the issues that affect higher-income people.

So the advertised deficit is $1.4 trillion. If we extend these provisions, it just increases the size of the deficit. So how do you do the tradeoff between the concerns on predictability by making these provisions permanent, recognizing this bill already is jeopardizing other programs because of the deficit and will be made worse if we just make these programs permanent?

Mr. ARENSMEYER. Well, there is continued confusion out there. I am not sure that the predictability issue is as great as some people are making it out to be.

You are absolutely right. If Congress is going to consider making these tax cuts permanent, then Congress needs to really understand where the benefits are and are not going.

And from a small business point of view and pass-through point of view, they are dramatically skewed to the very small number of very well-heeled pass-through entities, some of which you would not even call a small business.

And so I agree with you. I think you all need to think long and hard, "Gee, if we are going to make this permanent, maybe we ought to take a closer look at what it is doing," because you are just going to—not only are you going to exacerbate the deficit, but you are going to exacerbate the problem of the skewed benefits not really going to Main Street.

Senator CARDIN. Thank you.

Thank you, Mr. Chairman.

Chairman RISCH. Thank you very much.

Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman.

Tell me why you think the small business benefits are skewed to a select few.

Mr. ARENSMEYER. Well, Senator, it is simply just looking at data on how many businesses are pass-through, what their income is, what their marginal rate is, and all the different numbers that I gave in my testimony, there are different ways of slicing and dicing it.

Senator KENNEDY. But do not you think most small businesses in America are pass-throughs?

Mr. ARENSMEYER. Correct.

Senator KENNEDY. All right.

Mr. ARENSMEYER. But most of them are—the bulk of the income and the bulk of the benefit from a tax cut looking at marginal rates goes to the very small number at the very top.

Senator KENNEDY. So you are saying that people who pay more taxes are getting a bigger tax cut?

Mr. ARENSMEYER. Yes.

Senator KENNEDY. Or is that unfair?

Mr. ARENSMEYER. Well, they are not only getting bigger tax cut. They are getting a higher percentage tax cut. Somebody making eight times as much as somebody else is getting 25 times a bigger tax cut.

Senator KENNEDY. And what provision in the Tax Cuts and Jobs Act is doing that?

Mr. ARENSMEYER. The provision of allowing them to deduct 20 percent of their pass-through business income.

Senator KENNEDY. I know that, but how is that language in the Tax Cuts and Jobs Act skewed in favor of somebody who has a lot of pass-through income as opposed to somebody who has a little?

Mr. ARENSMEYER. Because you are taking 20 percent of not only more tax because they make more, granted, but they actually have a much higher marginal rate.

It is just a question of where the dollars are going. You are talking about $1.5 trillion. It is a question of where is the benefit going.

Senator KENNEDY. Well, no disrespect, but that is nonsense. I mean, if you are paying more in taxes, you are going to get a bigger tax cut. What is unfair about that?

Mr. ARENSMEYER. Well, I mean, one way to look at it is unfair, but the other thing is just a fact of where the benefit is going. The benefit is not going to Main Street. It all depends on what you——

Senator KENNEDY. How do you define Main Street?

Mr. ARENSMEYER. Smaller businesses that are in communities across this country with smaller numbers of employees. Eighty percent of all small businesses have fewer than 10 employees.

Senator KENNEDY. Is there a cutoff where you become a virtuous small business as opposed to some sort of greedy large business in your mind?

Mr. ARENSMEYER. Well, I mean, if you look at the benefit on the tax cuts, it gradually goes up, but it goes up geometrically. It goes up exponentially because of the combination of the higher income and the marginal rate.

Senator KENNEDY. Okay. Let me ask you about the Opportunity Zones. I forget who asked you, but it was a good question about the metrics. And I know we have a baseline because we know the employment and the number of businesses, et cetera, before the Opportunity Zones kick in.

But how do you know if there is growth that is going to be a result of the Opportunity Zones? I mean, we keep throwing money at problems we all want to solve without any metrics, without solving—understanding whether the money is giving the effect we want.

Mr. LETTIERI. Thank you for the question.

In this case, the incentive only goes to investments that have been made, A, in a qualifying business or qualifying properties.

Senator KENNEDY. Right.

Mr. LETTIERI. We know the constraint. But, B, because of the design of the incentive, it is not a tax credit, so there is actually no up-front subsidy. You are not getting any kind of up-front anything from Government.

Senator KENNEDY. Right.

Mr. LETTIERI. The incentive is to put——

Senator KENNEDY. You get a capital gains break.

Mr. LETTIERI. Right.

So you are putting private capital at risk over a long period of time. Therefore, the benefit only exists if the investment has been successful. If you have a successful equity investment in an oper-

ating business in a low-income area, in many ways, by definition, that means that the tax benefit has had the effect it was intended to have, meaning you have been a successful part of a successful business in a targeted area.

So we can measure——

Senator KENNEDY. How do you know the businesses would not have gone there, anyway?

Mr. LETTIERI. Well, in terms of relocation?

Senator KENNEDY. No. How are you going to know whether the—I am not arguing against it.

Mr. LETTIERI. No, no. I understand that.

Senator KENNEDY. I have just seen this movie before.

Mr. LETTIERI. Sure.

Senator KENNEDY. How do you know that the businesses would not have gone there, anyway?

Mr. LETTIERI. Well, the benefit is to the investor in the business. So it may drive relocation activity. I hope it will for businesses that are mobile and can opt into an area that there is higher need.

But the tradeoff here is obviously public expenditure for a certain type of public good behavior in the private sector, and so we do not know with perfect certainty—and it is impossible to know, unfortunately, with perfect certainty——

Senator KENNEDY. Let me cut you off because I am going to get cut off.

Mr. LETTIERI. Yeah.

Senator KENNEDY. Can I have just another minute?

Chairman RISCH. Feel free, Senator.

Senator KENNEDY. All right. Let me ask each of you this question. This is a philosophical question. State, local, and Federal Government are always spending money, giving tax breaks, tax expenditures—some call them "tax expenditures"—tax credits to try to stimulate the economy. When you do that, you benefit some people over others. And there are some people who game the system.

This is a question, not a suggestion. Do you think we would be better off if State, Federal, and local government all got together and say, "We are going to stop trying to buy business?" Just get rid of all of these breaks and incentives, and we are going to work on a Tax Code. And with all of the money that we saved from trying to bribe businesses to come to a particular area, to come to a particular State, we can lower the tax rate.

Now, I know we do not live in La La Land, and that is probably not going to happen. But would it work?

Professor.

Ms. BRUCKNER. No. And I also think that there are some tax incentives in the Code that are great.

The $5,000 deduction for startup cost for businesses can be really, really helpful. My survey data shows that people take it, and people like it. And it significantly helps with being able to offset their costs.

Senator KENNEDY. When you give people money, they generally like it.

Ms. BRUCKNER. Yeah, yeah, yeah.

I do think—to be fair, I do think that taxes are a really clumsy way to pump money into the system if you are trying to spark eco-

nomic activity. It works eventually, but I think people think that it is going to work much faster than it usually does.

Senator KENNEDY. Okay. That is fair.

Mr. ARENSMEYER. Senator, you are absolutely correct. This does happen more in the State and local level. Money that is designated as economic development money is often not targeted to the communities, and in many cases, it does benefit people outside the communities or a certain small segment of people in the communities.

So that said, there is a way to do economic development that is more focused on benefits for job creation, benefits in targeted communities, some of what John has talked about, the Opportunity Zones, having the data, looking at the metrics, and having some incentives in there for investment in local businesses and Opportunity Zones.

So I would agree with Caroline. It is a question of how you do it. If you are just giving out State and local subsidies to get big corporations to come in, there might be some small benefit, but again, it is a bang for the buck. And I do not think it is a cost benefit and the best way to use the money.

Mr. LETTIERI. Just to finish the answer earlier, this is not that. I would totally agree we should get rid of, in my view, almost every single one of the relocation and State and local type of poaching benefits, where the benefit is do you move across arbitrary border into an area?

This is different, again, because the business is not the recipient of the incentive. It is to motivate something that we know is not happening now. We already have these data. The business creation in the target areas that we are talking about is dismal.

In most cases, there is a higher failure rate than a startup rate. You are seeing a hollowing out. We will know if it is working. We will know if the trajectory changes because the trajectory is not good right now. It is motivating—this is targeted to a behavior that we know investors are not engaging in at scale now and certainly not to match the scale of the need, and we are paying for it because the very types of communities we are talking about, we just pay on the back end in terms of social safety net and other types of remedial programs that are very—speaking of clumsy, do not do much to open up economic opportunity, but help to address the casualty of a market that has failed in a local community. And in many cases, we are talking about decades of decline. So this is not just a private-sector problem. This is often public-sector neglect as well, and I think that is why this is more targeted.

Senator KENNEDY. Doc.

Ms. SLAUGHTER. Senator Kennedy, that is a very interesting hypothesis that we could get local, State, and Federal Government to do that, and I think it would be wonderful if we could. And we might be smarter and do this in a different way and better.

I am not sure if I would call it bribery, but performance-based incentives work, whether you are talking about an individual worker.

Senator KENNEDY. It sounds better.

Ms. SLAUGHTER. It certainly does. It is very diplomatic, but bribery works. So if we want to create internships and apprenticeship

programs and we offer some sort of benefit to businesses, large or small, for that, you will begin to see an increase in that.

I do think that the evidence will prove itself that these tax cuts are significant. The reinvestments, for example, the depreciation, nobody has brought that up, but immediately writing off assets and lowering the cost of capital is very significant for some of our clients. They are using that money to really do some marvelous things in their businesses, and that is a reinvestment that is going to last for many years. I will take this one.

Thank you.

Senator KENNEDY. Listen, you have all four been great. Thank you very much.

I went way over and——

Chairman RISCH. You did.

[Laughter.]

Senator KENNEDY. They will get me back, but thank you.

Chairman RISCH. Thank you, Senator Kennedy.

Thank you to the witnesses. This has been a really interesting conversation on a really interesting subject, and certainly, people have different opinions on this. But people are smart, and they can listen to these and make a decision as to which way they want to go with the ideas.

Senator Cardin.

Senator CARDIN. And I also want to join in thanking all four of our witnesses. I think this has been an extremely helpful presentation.

Senator Kennedy always makes very cogent points. I would just point out, if I might, that one of our concerns when targeting, that when you take a look at the lion's share of the business tax relief, it goes to C corporations. And C corporations are the larger companies. Very few small companies get the advantage of the C rate.

So those provisions that are made for the pass-through entities, where you get the largest number of small businesses, when you take a look at that pie, the majority of the tax relief is going to larger businesses, not the smaller business.

I think that is the point that we are trying to make, and I understand there are multiple reasons for it. And I think you raised some very important points, but I just think that was the point that we are trying to make.

And the second point on reducing rates and getting location of businesses, it is a hypothetical issue because it is hard to see that translate with State and local governments being coordinated with the Federal Government, but the challenge is that tax rates being equal, it is still difficult to locate in rural areas and in urban areas and in high unemployment areas. Generally, their tax bases are not as strong. So, generally, their rates are going to be higher and therefore a disincentive for a business to locate there.

So for all those reasons, we do need to compensate so that we can get underserved areas a better return for investors. I think that is the issue that we deal with, and it is not just the level of the rate. It is really the inequality in location that causes us to try to want to find some way to compensate.

I think that is what Senator Scott and Senator Booker were trying to achieve.

But, again, I thank all of our witnesses, and I thank the Chairman for his patience.

Chairman RISCH. Thank you.

And, again, thanks for taking the time to join us.

I am going to keep the record open 2 weeks from today at 5:00. If anybody else has something for the good of the order, feel free.

With that, the Committee is adjourned.

[Whereupon, at 4:14 p.m., the Committee was adjourned.]

APPENDIX MATERIAL SUBMITTED

Christel Slaughter, Ph.D.
CEO of SSA Consultants
Chair of the U.S. Chamber of Commerce's Small Business Council
Responses to Questions for the Record from the October 3, 2018 Hearing,
"Expanding Opportunities for Small Businesses Through the Tax Code."
Senate Committee on Small Business and Entrepreneurship

Questions from Senate Committee on Small Business and Entrepreneurship Chairman Jim Risch:

Q1) How involved was the Small Business Council in advocating for tax reform?

A: The Small Business Council is one of several policy committees at the U.S. Chamber of Commerce. Tax policy has traditionally been a top concern for small business and, therefore, was a high priority for our Council. Our Small Business Council presented testimony in the House and in your Committee on March 29, 2017. Additionally, my predecessor as Chair, Maxine Turner, wrote opinion pieces on tax reform along with several other testimonials from Council members and other small businesses. U.S. Chamber of Commerce President & CEO, Tom Donohue, has consistently advocated for tax relief that would benefit corporate and individual taxpayers, insisting that tax cuts for both large and small businesses were necessary to spur economic growth.

Q2) How did you feel tax reform would benefit small businesses?

A: The Small Business Council believed that lowering rates for corporate and individual taxpayers (including small businesses that file as individuals and pass-through entities) would result in economic growth. Maxine Turner, who chaired the Small Business Council during passage of the Tax Cuts and Jobs Act of 2017, explained how tax reform would benefit small businesses in an opinion piece that was published on December 17, 2017. That piece may be accessed at: https://www.uschamber.com/series/the-case-tax-reform/small-business-tax-reform-imperative-economic-growth

Q3) In your conversations with small business owners as the Chair of the Chamber of Commerce's Small Business Council and small business owner yourself do you believe that small businesses are fully taking advantage of the provisions in last year's tax reform law?

A: I believe that small business owners who have sat down with their tax advisor or Certified Public Accountant (CPA) are taking advantage of the provisions in the Tax Cuts and Jobs Act of 2017. Unfortunately, I do not think that the majority of small business owners have had those necessary discussions with professional advisors and, therefore, have not taken full advantage of provisions in last year's tax reform law.

Q4) What advice have you given to small businesses to ensure they're receiving the full benefits of the law?

A: I consistently tell my peers to seek advice from the professionals (tax advisors and CPAs) in order to take advantage of last year's tax reform law. The Chamber's Small Business Council published similar advice in an opinion piece that may be accessed at: https://www.uschamber.com/series/above-the-fold/what-do-the-big-tax-reform-changes-mean-your-small-business-we-ve-got-answers.

Q5) You run a small business yourself, correct?

A: Yes.

Q6) Do you have clients who are small businesses?

A: Yes.

Q7) From both your personal perspective and your position as Chair where you are working with businesses from across the country, what message are you receiving from these businesses?

A: I am hearing that small business owners are grateful that (a) their employees are taking home more pay; and (b) they can re-invest tax cut savings into their own businesses.

Q8) Are they excited about what the tax reform law can do for their business sustainability and growth?

A: Yes, small business owners are excited about re-investing any savings realized from tax reform to bolster their business's viability through growth, providing more employee benefits, or capital improvements. The U.S. Chamber of Commerce/MetLife Small Business Index surveys 1,000 small businesses every quarter. When tax reform passed, the small business owners surveyed were twice as likely to think tax reform would help their business than hurt it.

Q9) Your testimony referenced a map of businesses that are reinvesting savings from tax cuts.

A: Yes, the U.S. Chamber of Commerce maintains a map of businesses, large and small, that are reinvesting savings from tax reform. That map may be accessed at: www.uschamber.com/tax-reform.

Q10) Will you please provide the Committee with a more detailed explanation of the map?

A: The map which may be viewed at www.uschamber.com/tax-reform, graphically depicts the positive impacts of tax reform. It shows the names and locations of businesses and shows how those businesses reinvested tax cut savings. On the map, blue dots represent employee bonuses, yellow dots represent price cuts, and green dots represent a combination of benefits, including expansion and capital improvements.

Questions from Senator Heidi Heitkamp:

Marty Sullivan, a columnist for the journal Tax Notes, described some of the uncertainty created by the new tax law for those making over the income thresholds. For example, the statute and the proposed Treasury guidance try to sort out which businesses are "specified," and therefore are disqualified from taking the deduction. According to the Treasury's guidance, physical therapy businesses are ineligible for the deduction. But occupational therapy businesses still may be OK. Dental practices are out, but optometrists may be good. Similarly, actors are disqualified as performing artists, but news readers or disc jockeys may not be.

Question 1:

Ms. Slaughter, in light of the Treasury's August guidance, should more be done to level the playing field for similarly situated business owners?

A: Yes, Treasury can provide greater certainty when it finalizes its guidance. The U.S. Chamber of Commerce submitted comments to IRS consistent with this approach. The comments may be accessed at: http://bit.ly/2Om2NESmallBizTaxIRSComments

Question 2:

Is the construct of the tax law unilaterally creating winners and lowers within our economy without regard to the underlying economic activity and value that the business actually creates?

A: I believe that lowering rates across the board, for corporate filers and individual filers (small businesses that file as individuals and pass-throughs), was a good way to reform that tax code and stimulate growth. Small businesses have historically created the majority of net new jobs and there is tremendous value in job creation at a community and national level.

Senate Committee on Small Business and Entrepreneurship Hearing
October 3, 2018
Follow-Up Questions for the Record

Questions for Mr. John Lettieri

Question from Chairman Risch:

What benefits to entrepreneurs and small businesses do you see from coupling Opportunity Zones with programs like this one?

The SBA's change to the definition of underserved communities for their Community Advantage program to include Opportunity Zones is a positive step and a great example of how the federal government can align policies and programming behind this new market incentive. An Opportunity Zone company with SBA support will find it much easier to attract private capital, given the important signaling role that the Agency's programs provide to other lenders. Such alignment will increase the likelihood that new and small businesses scale and survive in Opportunity Zones, which is central to the intent of the legislation. Creating this sort of self-reinforcing ecosystem is essential to fostering a mutually beneficial outcome for taxpayers, for investors, for businesses, and for communities. We hope to see much more alignment across federal investments and programs emerge, and we hope that states and localities follow suit. Opportunity Zones are a very compelling organizing principle for these efforts.

Questions from Senator Heitkamp:

How would you define a successful Opportunity Zones program in terms of its benefit to Main Street, and also to rural America?

The Opportunity Zones incentive will be successful if it becomes a versatile and widely-used economic development tool to spur new investment across a wide array of communities, including rural communities and small-town Main Street corridors. This will require both effective federal rulemaking and thoughtful state and local strategies.

The Economic Innovation Group's 2018 Distressed Communities Index identified an increasing ruralization of economic distress in this country. The total number of rural Americans living in a distressed zip code rose by nearly 1 million from the 2007-2011 to 2012-2016 periods even as the total number of Americans living in such struggling communities fell. Nationwide, 76 percent of counties had fewer business establishments in 2016 than in 2007, and digging deeper we see that rural counties (those with fewer than 100,000 people) largely bore the brunt of that trend, with only 20 percent of rural counties seeing positive establishment growth over that period, versus 38 percent of suburban counties and 58 percent of urban counties.

The Opportunity Zones initiative could help address these trends. Signs of local success in rural and small town Opportunity Zones will include increased levels of investment, higher rates of business formation, lower poverty rates, higher employment, and faster income growth in the years ahead.

What is the measure of success in these places?

Apart from the "graduation rate" at which zones no longer meet the threshold qualifying criteria thanks to inward investment and community success, we should be particularly focused on the rate of new business starts and frequency of business expansions. These will tell us how successful the provision has been at seeding the next generation of employers, innovators, and economic anchors in the target communities.

With a program of this size being implemented across the country for the first time, how do we ensure that the benefits of the Opportunity Zones program accrue to all, including women, including minorities, and those that have not traditionally had as much access to capital?

Opportunity Zones are an important new tool we hope will serve as a cornerstone of state and local economic development policy. State and local efforts – both policy and practical – will be critical to ensuring that capital flows into a diverse set of uses that prioritize community benefit at the local level. The federal incentive is a potentially powerful tool, but it is no substitute for a thoughtful and inclusive local strategy. State and local leaders should pursue supporting and complementary programming — working with local, civic, non-profit, and private sector partners — to cover the last mile and truly connect the capital unlocked by this new tax incentive with underserved communities and constituencies. Since the law's passage, my organization and several others have been touring the country with exactly this message.

Question from Senator Duckworth:

As we await the first round of proposed rulemaking, what specific adjustments could be made to Opportunity Zones to guarantee small businesses in communities such as Cairo and Golconda receive much-needed investments from Opportunity Zone tax incentives?

First, I would point out that there is no guarantee that investment will flow to any specific region or census tract. Given that, we hope to see state and local leaders mobilize around this opportunity to facilitate and direct investment into small businesses in the communities in need of revitalization. They can do this by raising awareness among startups and scaleups in these communities, by layering additional incentives or programs of their own, and by serving as an information broker to help ensure viable businesses have the tools and resources they need to become eligible for Opportunity Fund investment.

On the regulatory front, there are a handful of factors that, if addressed properly, would facilitate investment in startups and existing small businesses in these communities.

First is ensuring that key terms and tests in the regulatory framework provide enough flexibility for a wide range of businesses to qualify without the kind of complicated rules or compliance burdens that have limited participation in other programs. For example, in the requirement for "substantially all" of a business' property to be located within an Opportunity Zone, Treasury's initial proposed rule sets the threshold at 70%, which provides the practical flexibility that allows a greater range of new and existing businesses in these communities to qualify and be eligible for investment.

A second critical issue is ensuring that Opportunity Funds themselves have adequate time to identify qualified operating businesses. Treasury can achieve this by providing a reasonable and clearly-defined grace period that treats cash raised by a fund to be deemed compliant with the semiannual asset test – similar to the approach used in other tax incentive programs. Without such timing flexibility, funds will be discouraged from making investments in new and small businesses.

Finally, there are many questions about how the rules will treat capital "recycled" by an Opportunity Fund back into new investments in Opportunity Zones. This is important in the context of investing in startups and small businesses, as the fund cycle for investing and exiting such businesses is often shorter than 10 years and investors often have little control over the timing of an exit. Clarifying that individual investors must hold their stake in an Opportunity Fund for the required 10 year period, while allowing the fund to naturally invest, exit, and re-invest according to the market, would help ensure Opportunity Zone investment flows into operating businesses.

SMALL BUSINESS MAJORITY

The Honorable James E. Risch
Chairman, Committee on Small Business & Entrepreneurship
United States Senate
Washington, DC 20510-6350

RE: Responses to Questions for the Record following the hearing on "Expanding Opportunities for Small Business through the Tax Code"

Dear Chairman Risch and other members of the Committee:

Please find below my responses to the follow-up questions submitted following my participation in the October 3, 2018 hearing, "Expanding Opportunities for Small Businesses Through the Tax Code."

Thank you for the opportunity to continue the conversation on this important topic.

Sincerely,

John C. Arensmeyer

John Arensmeyer
Founder & CEO

Questions from Chairman Risch

QUESTION 1:

Your written testimony states that the complexity of the new deduction for pass-through businesses "means any savings will go towards tax professionals to help entrepreneurs navigate their taxes." The majority of small businesses earn below the $315,000 taxable income threshold before any limitations begin. For these businesses, they must take the taxable income earned by the owner from the business and multiply this taxable income by 20 percent (or 0.2).

Can you expand on how this process is more complicated for these small businesses?

The Tax Cuts and Jobs Act was not designed to materially benefit small businesses or save them much money. Specifically, the treatment of pass-through entities gives the bulk of the benefit to the wealthiest pass-through entities, rather than Main Street by giving a whopping 77% of the pass-through reduction benefit to the top 2.6% of firms. Indeed, the financial benefits to a pass-through entity making $500,000 are 20 times the benefits to a business making $75,000.

What's more, Section 199A of the law, which pertains to the changes in the pass-through deduction, did not take steps to clarify how small business owners determine their qualified business income (QBI). The regulations recently released by the IRS regarding Section 199A do not explain if other tax provisions like the deduction for health insurance for self-employed individuals, the state income tax itemized deduction or the retirement plan contributions of a sole proprietor reduce QBI.

This lack of clarity means a small business owner must make complicated decisions in determining their QBI, increasing their reliance on tax professionals and further disadvantaging small businesses who do not have the resources larger companies have to navigate complicated tax filings. Public opinion polling reveals a high level of confusion among small business owners, with a survey from the National Small Business Association finding that only 7% of small businesses believe filing taxes will be easier under the new law.

QUESTION 2:

It is true that the vast majority of small business owners rely on tax professionals. Now that the small business pass-through deduction regulations have been proposed and can be relied upon until final regulations are issued later this year, accountants and tax advisors have important details to prepare small businesses' taxes. Preparation costs may increase slightly this year for initial compliance, but only modestly. The Regulatory Flexibility Analysis included in the proposed rules for the section 199A small business pass-through deduction estimates a compliance burden of 30 minutes to 2.5 hours for small businesses.

Once those initial compliance processes are established, won't the benefit be more significant in future years?

Without further simplifications to the tax code, it is unlikely compliance costs for small business owners will be significantly reduced in the future. This is reflected in the way small business owners are planning for future years. A **report** co-authored by Anne Zimmerman, a member of our national Small Business Council who owns a small public accounting firm in Ohio, found the 20% deduction on qualified business income is unlikely to generate enough savings for real small businesses to hire new employees, invest back into their businesses or make operational improvements. Additionally, recent polling from ZipBooks, an online accounting software company that serves more than 100,000 small businesses, found 88% of small business owners say the new tax cuts have had no impact on their hiring decisions.

Even once small business owners are able to more easily navigate the changes in future years, their benefit is still very small, especially compared to the wealthiest pass-through entities.

QUESTION 3:

Will the benefit of the 20 percent deduction outweigh the modest cost of compliance?

As stated in my testimony, and as summarized above, very few Main Street small business owners will see a significant benefit from the Tax Cuts and Jobs Act.

Small Business Majority promoted a more limited small business health insurance tax credit included as part of the ACA. This credit was much more limited than the small business pass-through deduction based number of employees, average premiums, and average salaries. The Small Business Health Insurance Tax Credit instructions (Form 8941 Instructions) estimates a compliance burden of 15 hours, far outweighing the modest benefit.

Can you clarify this disconnect?

The Tax Cuts and Jobs Act and the Small Business Health Insurance Tax Credit are significantly different tax issues and are not equivalent burdens for small business owners, as the Tax Cuts and Jobs Act influences all small business owners and their ability to easily file their annual taxes. That said, we do believe the Small Business Health Insurance Tax Credit should be expanded and simplified so more small businesses can take advantage of the credit.

Specific ideas for this include expanding the tax credit to those who offer any ACA-compliant plan in the small group market, now that online enrollment through the federal SHOP marketplace is no longer

available. We expect few small businesses will be utilizing SHOP and the tax credit now due to the changes to the enrollment system, and expanding the tax credit would help more small businesses offer health coverage.

Additionally, we would suggest simplifying the determination for the tax credit by using criteria based on the previous year's tax returns and employment level as of a certain date (e.g. 12/31 of the previous year), rather than a month-by-month determination as the year unfolds. We also recommend raising the limits on the tax credit, particularly as the employee size and income limits combine to close out the credit very quickly.

QUESTION 4:

Did Small Business Majority analyze and comment on the Qualified Business Income Deduction proposed rules from the Treasury Department and Internal Revenue Service (IRS)?

QUESTION 5:

Your written testimony said, "Simply put, small business owners wanted a simplified and more streamlined tax system that would also help level the playing field with large corporations, and they got the opposite."

Did the increased individual Alternative Minimum Tax (AMT) thresholds simplify tax compliance for small business owners?

In response to both questions 4 and 5, Small Business Majority is primarily concerned with the structure of the pass-through deduction, as this affects the way the vast majority of small business owners file taxes. Indeed, according to the Brookings Institution, 95% of small businesses are pass-throughs. The increased individual AMT thresholds are unrelated to the QBI deduction and do not help small business owners understand the complexities of determining their qualified business income.

QUESTION 6:

Your written testimony recommended, "allowing small businesses to deduct their first $25,000 in business income whether or not they file their tax returns as a pass-through entity or as a C-Corporation." The Tax Cuts and Jobs Act (TCJA) nearly doubled the standard deduction to $24,000 for joint filers. The nearly doubled standard deduction can be combined with the pass-through business deduction.

Do these changes come close to satisfying your recommendation?

QUESTION 7:

Does doubling the standard deduction simplify the code for small businesses?

In answer to both questions 6 and 7, we do not feel that the changes to the standard deduction satisfied our recommendation. Everyone receives the standard deduction, but, in addition, the personal deductions available to all taxpayers (standard and itemized) we proposed an alternative to the pass-through deduction that would structure the benefit in a way that would result in substantial savings for Main Street small businesses, rather than wealthy pass-through entities.

QUESTION 8:

When answering questions before the Small Business Committee, you referenced the Small Business Majority's support for measures that would allow the self-employed to benefit from pre-tax deductibility of health insurance premiums the way CEOs of large

corporations are able to benefit. The Committee is aware of a final regulation promulgated by the Employee Benefits Security Administration on June 21, 2018 that accomplishes what you referenced (See 83 FR 28912 (pages 289-28933)).

Does the Small Business Majority support the U.S. Department of Labor's rule, referenced immediately above, that will extend pre-tax deductibility of health insurance premiums to the self-employed?

While Small Business Majority does support proposals that allow premium deductions for self-employed individuals, this does not extend to support for the recent expansion of association health plans (AHPs), which is the primary concern of the referenced regulation. Under the new Department of Labor rule finalized in June 2018, it will be easier for a few select small businesses with younger and healthier employees to participate in an AHP.

This will be detrimental to small businesses as it will create separate risk pools in the small-group insurance market—one pool for businesses that want bare-bones plans and one for firms that need more comprehensive coverage. This will lead to increases in premiums for small businesses with older or sicker workers. Additionally, AHPs offer few consumer safeguards and have traditionally been some of the most fraudulent health plans on the market prior to the ACA.

QUESTION 9:

In your testimony, you focus largely on your view that the pass-through provision does not work for small businesses. However, the tax reform law included a number of other provisions geared toward providing small businesses with the opportunity to grow, including expanding Section 179 expensing, bonus depreciation, and the Opportunity Zones policy, to name some of the topics discussed in the hearing.

Has Small Business Majority looked into these provisions at all?

Small Business Majority has looked at these provisions, and as stated in my testimony, we are in favor of some of these individual provisions. Particularly, Small Business Majority supported the creation of Opportunity Zones. However, these zones must be implemented responsibly and in a way that benefits small businesses. This could be accomplished by requiring reporting metrics that measure program success based on the number of jobs created, where those jobs are located, employee wages and the number of businesses created, particularly businesses formed by women or people of color.

We also supported legislation in 2016 that made Section 179 expensing permanent at the $500,000 level and we have supported the more recent increase to $1 million. Specifically, the prior law allowed small businesses to deduct up-front the cost of purchasing new equipment and property for up to $510,000 in qualified property costs. Under TCJA, the maximum expensing was increased to $1 million and the phase-out threshold amount to $2.5 million.

However, we did not support the increase in the first-year bonus depreciation beyond the Section 179 levels, as there would be little benefit for most Main Street small businesses and the lost revenues could be better deployed either in a more targeted small business tax cut or toward reducing the deficit.

<u>Questions from Senator Heitkamp</u>

QUESTION 1:

I would like to ask you about the new pass-through deduction under Section 199A of the TCJA. To be clear, I think directionally giving small businesses owners tax relief is the right idea. However, as drafted, I'm worried that the new Section 199A creates far too much complexity for small business owners. I'm also very concerned about the uncertainty it

presents to business owners who will be faced with the potential of losing the deduction starting in 2026. Entrepreneurs need certainty to plan and grow their businesses, and this law was inexplicably designed to add, not limit, uncertainty.

Mr. Arensmeyer, for pass-through owners that are below the cut off of $315,000 if they're married, or $157,500 if they're single, can you explain some of the difficulties they may have with determining how to calculate "qualified business income" which is subject to the 20% deduction? –

The tax law's Section 199A pass-through deduction provisions do not materially benefit small businesses or save them much money. Specifically, the treatment of pass-through entities gives the bulk of the benefit to the wealthiest pass-through entities, rather than Main Street by giving 77% of the pass-through reduction benefit to the top 2.6% of firms. Indeed, the financial benefits to a pass-through entity making $500,000 are 20 times the benefits to a business making $75,000.

Regarding the Section 199A regulations, these regulations did not adequately clarify how small business owners determine their qualified business income (QBI). Recent regulations from the IRS do not clarify if other tax provisions like the deduction for health insurance for self-employed individuals, the state income tax itemized deduction or the retirement plan contributions of a sole proprietor reduce QBI.

QUESTION 2:

Although the cut off was intended to create simplicity for the smallest of pass-through businesses, given some of the uncertainty with the new QBI concept do you anticipate additional compliance costs for these businesses?

We believe more small business owners will need to turn to tax professionals to navigate the confusion over determining their QBI, with the potential to increase compliance costs significantly. The proposed regulations for Section 199A are 184 pages long, with an additional 14 pages of W-2 compliance guidance. What's more, the IRS estimates the cost of compliance with this section could cost $1.3 billion over ten years.

Small business owners are unable to understand regulations with this level of complexity and will need to dedicate precious time and money to complying with the tax law. This is particularly problematic for small businesses operating on tight profit margins. We know this will prevent small business owners from reinvesting profits back into their business or hiring more employees.

<u>Questions from Senator Hirono</u>

QUESTIONS 1-6:

Making the tax law work for working and middle class families: Mr. Arensmeyer, the Institute for Taxation and Economic Policy ("ITEP") has estimated that with the most recent tax proposal ("Tax Cuts 2.0") the wealthiest 1 percent of households in Hawaii will receive more than 10 percent of the benefits, and the wealthiest 20 percent of households will receive around 60 percent of the benefits.

Additionally, even as last year's tax law has provided massive tax breaks to support large corporations and shareholders (who have benefited from more than $700 billion in stock buybacks this year alone), wage growth for workers has remained weak, and, by some measures, has even declined when considering inflation.

Basically, the early results are in—large corporations and wealthy people are doing very well, yet we are not seeing large increases in wages or business formations.

Making the tax law work for small businesses: Mr. Arensmeyer, several of the provisions from last year's tax law have benefited large corporations and businesses with greater resources, who may be better positioned to take advantage of the law's changes than many small and medium-sized businesses. Additionally, contrary to claims that the law would simplify the tax code for small businesses, we know that when asked many small business owners have expressed concerns about the financial costs and complexities that will accompany the tax law's changes.

What, in your assessment, should we be doing to make sure the tax law is benefitting working and middle-class families, specifically those who own or work for small businesses?

What specific changes should we consider to better promote wage growth?

What changes should we consider to better promote the formation of new businesses?

What changes should we consider in the near- and mid-term to better support small- and medium-sized businesses?

How can we alleviate the burdens of the tax law on these businesses, and, furthermore, how can we help these businesses navigate the law's changes?

What other changes should we consider to expand opportunities for small businesses and entrepreneurs?

Now that the 2017 Tax Cuts and Jobs Act is established law, we must turn to concrete policy solutions that could better serve our nation's entrepreneurs within the reformed system. I offered several policy solutions in my testimony, including the following:

- Ensure Opportunity Zones guidelines are designed to benefit Main Street small business owners rather than focusing on incentivizing real estate development. While investments in Opportunity Zones hold the potential to benefit small businesses, especially those in underserved communities, they must be implemented responsibly. This could include requiring reporting metrics that measure program success based on the number of jobs created, where those jobs are located, employee wages and the number of businesses created, particularly businesses formed by women or people of color.
- Make the New Markets Tax Credit permanent. This tax credit, which is set to expire at the end of 2019, has helped attract more than $60 billion in private sector funding to build businesses in economically-distressed communities across the United States.
- Align form 1099 reporting thresholds and streamline income reporting for independent workers.
- Identify and fix tax issues unique to micro-enterprises and freelancers, such as burdensome quarterly tax filings for freelance employees.
- Pass healthcare tax equity for the self-employed so that freelancers can deduct their healthcare expenses from their FICA tax obligations—just like other business entities.
- Establish a standard business deduction for independent workers. A standard business deduction in line with personal standard deductions could streamline the deducting of business expenses for solo-entrepreneurs.

In addition to the above policy solutions that were in my testimony, we believe the following policy solutions could expand opportunities for small businesses and entrepreneurs:

- Increase limits for deducting start-up and organizational expenses from the current $10,000 levels to $20,000 each.
- Maintain and expand Small Business Administration (SBA) lending, counseling, and procurement programs. This must also include providing small businesses, particularly minority businesses,

with increased opportunities to participate in SBA loan programs and small business development center programs.

- Maintain and expand the Community Development Financial Institutions (CDFI) Fund.
- Increase the national minimum wage to $12 per hour, and support state and local efforts to enact local wage authority—understanding that creating a fair minimum wage is essential to the vibrancy of the small business economy by boosting consumer demand, reducing the burden on public assistance programs and leveling the playing field for small businesses that understand the need for properly-compensated workers.

QUESTION 7:

Concerns about Medicare and Social Security: Mr. Arensmeyer, recent estimates from the Tax Policy Center have indicated that the second round of tax cuts included in the "Tax Cuts 2.0" proposal would increase the federal deficit by an additional $3.8 trillion (between 2026 and 2038)—so, even as last year's tax law provided massive tax breaks for large corporations and shareholders, this new proposal could further increase deficits and threaten important social programs like Medicare and Social Security.

Are you concerned about the tax law's longer-term impact on these or other programs, and what that could mean for small businesses and entrepreneurs in the United States?

Tax Reform 2.0 doubles down on the same problems found in the Tax Cuts and Jobs Act. The newest proposal once again gives the overwhelming majority of tax relief to the wealthiest businesses and individuals with minimal benefit for most small firms. On top of the $1.5 trillion cost over 10 years for TCJA, Tax Reform 2.0 would cost another $657 billion over the next decade. This is an enormous amount of money to spend for almost no benefit to most Main Street small businesses. According to our opinion polling, we know many entrepreneurs oppose reducing Social Security and Medicare as a way to reduce the federal deficit, and we know many small business owners rely on public programs like Medicaid and Medicare. Reducing these benefits would significantly hurt small business owners. Increased deficits also limit our ability to deal with future economic downturns and issues.

Question from Senator Duckworth

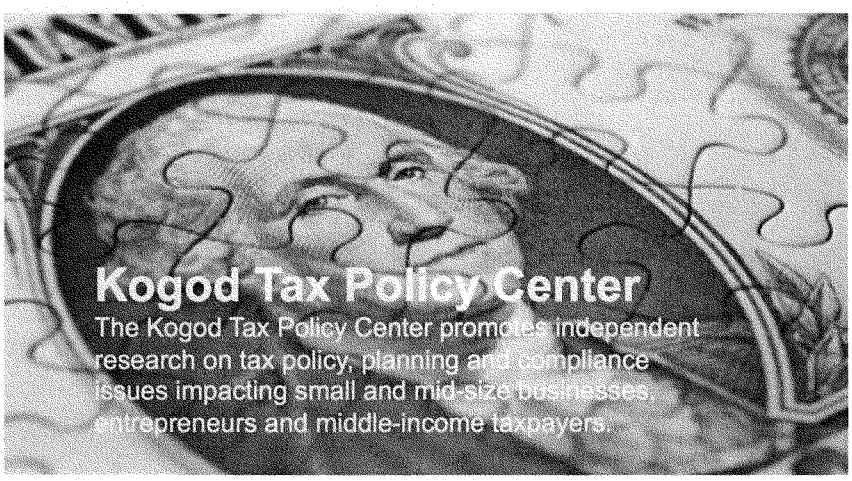
QUESTION 1:

Your testimony noted that large corporations and the wealthiest pass-through businesses will receive the lion's share of the tax benefits from the 2017 tax law. You also shared the views of my constituent, Jessica Jolly, who is frustrated that the tax law failed to incentivize small business growth and retention, while doing little to encourage start-ups and support entrepreneurs.

Moving forward, what would you advise Congress prioritize when it comes to making our tax code more friendly for small business start-ups in Illinois and across the country?

As stated in my testimony, Small Business Majority supports changes to the tax code that benefit small businesses from the bottom up. During the debate over tax reform in 2017, we proposed allowing small businesses to deduct their first $25,000 in business income whether or not they file their tax returns as a pass-through entity or as a C-Corporation. This would have ensured that changes to the tax code would have a significant, direct benefit to small businesses and self-employed individuals as opposed to large businesses, hedge funds and the very wealthy. Moving forward, we urge Congress to prioritize legislation that will have a direct, significant benefit to Main Street small businesses, rather than large corporations and wealthy individuals.

KOGOD SCHOOL *of* BUSINESS
AMERICAN UNIVERSITY • WASHINGTON, DC



Expanding Opportunities for Small Businesses Through the Tax Code

Hearing of the United States Senate Committee on Small Business and Entrepreneurship

Thursday, Nov. 1, 2018

Responses to Questions for the Record

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CHAIRMAN RISCH QUESTIONS

QUESTION 1: Do you think women entrepreneurs and small business owners would be faring better absent passage of the tax reform law?

ANSWER 1: Most women business owners and small businesses will see lower tax rates as a result of the TCJA, however the full impact of the legislation remains to be seen. While I hope that tax reform works to create opportunities for small businesses to access capital, I am concerned by CBO's prediction that health care premiums in the non-group market will increase by 10% each year in the next decade as a result of the repeal of the individual mandate. This will disproportionately impact small businesses.

QUESTION 2: Can you speak to the benefits women business owners, and small business owners generally, may receive from this innovative provision included in the Tax Cuts and Jobs Act (TCJA)?

ANSWER 2: My research, Billion Dollar Blind Spot, indicates that when small business tax incentives are designed to prioritize manufacturing or investment in capital intensive tangible property, women businesses owners do not benefit to the same degree as male-owned firms because women business owners tend to operate in services and have fewer capital intensive investments as business expenses. In contrast to other small business tax incentives, the Opportunity Zone legislation does not include prohibitions on investment in service firms or require investment in tangible personal property, which would help to enable women business owners in eligible areas qualify for investment.

QUESTION 3: Will the new section 199A benefit women-owned businesses more broadly than sections 1202 and 179?

ANSWER 3: Most women business owners will see a limited benefit from IRC Section 199A, which Congress targeted to individuals with business income. This is a significant difference from IRC Sections 1202 and 179, which were designed to help small businesses access capital and simplify their taxes, but tend to exclude or bypass the majority of women-owned firms altogether. However, by 2024, the Joint Committee on Taxation (JCT) projects that more than half of the revenue loss from Section 199A will flow to firms with $1 million of income. At the same time, the latest data on women-owned firms shows only 1.7% women-owned firms have incomes of more than $1 million and indicates a majority of those firms are likely to be in services. As a result, the latest data on women-owned firms suggests that less than 1% of women-owned firms will benefit from more than half of the revenue loss of Section 199A in 2024.

SENATOR HEITKAMP QUESTIONS

QUESTION 1: What explains, in your view, the absence of research on the effectiveness of federal tax legislation, as well as other laws, designed to assist small business owners?

ANSWER 1: For far too long, tax policy experts have failed to consider the implications of tax policy on women-owned firms, and, instead, have assumed that the U.S. tax code does not reflect gender bias because of efforts over the years to remove expressly discriminatory language. This commonly accepted assumption—and failure to consider that implicit gender bias may be operative—has resulted in the failure of government researchers and economists as well as Congress to consider the gender implications of small business tax incentives on women-owned firms.

For example, when I first raised these questions as a U.S. Senate Small Business and Entrepreneurship Committee staffer in connection with my work on the *Small Business Jobs Act of 2010*, I was informed by Treasury, SBA and IRS officials that they do not regularly collect specific data on how the U.S. tax code impacts women business owners. Instead, they collect data on small businesses generally, despite publishing research on the greater challenges women business owners have accessing capital. Later, as an academic researching these issues, I was told by a former Staff Director of the Joint Committee on Taxation that this kind of tax research doesn't matter because the U.S. tax code doesn't overtly discriminate against women business owners. Moreover, when my team and I reviewed more than 1,270 hearings of the Congressional tax-writing committees from 1986-2016, we were unable to identify a single full-committee hearing that considered the impact of small business tax incentives on women-owned firms in more than 1,500 days of hearings.

At the same time, the Congressional small business committees have routinely held hearings and commissioned research on challenges women-business owners have accessing capital. However, these committees do not have jurisdiction over tax issues. In my experience, these committees focused their hearings on women-owned firms to considering policy solutions over which they have jurisdiction. That noted, Congress has an oversight responsibility to account for how it spends taxpayer money and who benefits, particularly when it comes tax expenditures, which are akin to direct spending federal programs that function as entitlements to taxpayers who meet established criteria.

QUESTION 2: Which agencies and departments within the federal government do you think are best-situated to collect small business data as it relates to women-owned firms?

ANSWER 2: The IRS, working with the National Women's Business Council, the SBA and U.S. Census Bureau.

QUESTION 3: Would you agree with asking that more IRS information be made available for research and analysis?

ANSWER: Yes, however, given taxpayer privacy concerns, IRS should be directed to work with the U.S. Census Bureau to develop comprehensive data. Moreover, this data should be regularly collected and published as part of the IRS Tax Stat series.

QUESTION 4: If yes, can this be done in such a way as to preserve taxpayer privacy?

ANSWER: Yes. The U.S. Census Bureau often "backfills" its survey data with IRS data. Working together, the two agencies can develop methodologies to develop the necessary demographic data to analyze tax expenditures. The reason this hasn't been done before is because these agencies have never bothered to consider the gender implications of these tax incentives on women-owned firms or been directed by Congress to develop this data.

SENATOR HIRONO QUESTIONS

QUESTION 1: What specific changes should we consider to better support women- and minority-owned businesses?

ANSWER 1: First, Congress should conduct oversight on tax expenditures included in the U.S. tax code targeted to help small businesses access capital and grow their businesses. Such oversight efforts would include requesting JCT prepare formal estimates of the cost and distribution of the revenue loss of small business tax expenditures (e.g., IRC Sections 1202, 179, 1244, 199A and 199A) in terms of income, industry and demographic data, including gender, race, ethnicity, and age. If JCT is unable to prepare this data, Congress should task the U.S. Government Accountability Office with doing so.

Second, this Committee should request the Congressional tax-writing committees hold hearings on the issues raised in *Billion Dollar Blind Spot* as well as the implications of enhancements to Section 179 and the new Section 199A on women-and minority-owned firms. Congress needs to hear from businesses who may or may not benefit from these provisions to understand the impact of the design of the tax expenditures and to account for the distribution of these taxpayer dollars among U.S. businesses.

Third, Congress should pass legislation requiring the IRS develop and publish as part of its Tax Stats series regular data on women-and minority-owned firms their ability to claim business tax expenditures. Data is necessary to enabling Congress to make evidence-based tax policy decisions, however, under current law, the IRS is not required to collect this data and it undermines Congress' ability to discern where and how to target tax incentives to these businesses.

QUESTIONS 2&3: Based on your research, could you elaborate on how these changes would help to support these businesses? Can you elaborate further on how increased access to capital would help to support these businesses?

ANSWERS 2&3: To date, Congress has failed to consider how tax incentives impact women-business owners' ability to access capital, which is a more severe challenge for these firms. At the same time, the latest research indicates that the total number of women-owned firms has increased over the last ten years by 58%. Indeed, women of color are leading this charge and own 64% of the new women-owned businesses launched each day. In fact, women business owners have grown from 4.6% to 40% of all firms in just my lifetime. That is a remarkable trend that spans multiple economic downturns. These firms are a bright spot of new growth for the overall economy, but academic and government research finds that these firms still struggle to access capital, grow and scale. By developing tax research data on how women business owners claim small business tax incentives, Congress could make better informed decisions to help these small businesses continue to grow and weather economic challenges.

QUESTION 4: Considering this issue from a tax perspective, could you elaborate on your recommendations to the Committee and identify other areas where more information on women- and minority-owned businesses might be helpful as we discuss how to better support these businesses?

ANSWER 4: Oversight is an underutilized tool that Congress can employ to consider who benefits from small business tax incentives and determine whether these tax incentives are operating as intended. By conducting hearings specifically on these issues and directing government tax researchers such as JCT, CRS and GAO to develop tax data that reflects income and industry distribution as well as gender and demographic information, Congress will be better able to make evidence-based policy decisions to target incentives to generate optimal returns on investment.

To date, government tax research has neglected to consider the gender implications of business tax incentives – while women business owners have grown to represent 40% of all U.S. firms. Moreover,

the academic and government research that does exists routinely finds that women business owners specifically have greater challenges accessing capital than their male counterparts. Put simply, we have missed the mark and an opportunity to help fuel these firms. The disconnect between available research and Congressional tax policy tools to address the challenges women- and minority-owned businesses face accessing capital should be remedied.

QUESTION 5: What kinds of studies or reports would you like to see federal agencies conduct on women- and minority-owned businesses to inform these discussions?

ANSWER 5: The IRS, working with the National Women's Business Council, the SBA and U.S. Census Bureau, should develop regular tax research data on these businesses and their and business tax incentives and should publish this data regular as part of its Tax Stats series. Understanding how and whether women business owners can claim tax incentives to access capital and grow their businesses is necessary to Congress' conducting its oversight of tax expenditures, which function as federal entitlement programs.

QUESTION 6: Could you elaborate on how more information about tax expenditures for women-owned businesses could inform these discussions?

ANSWER 6: Congress and taxpayers are entitled to an accounting of how the revenue loss of tax expenditures is distributed among businesses. Taxpayers ultimately foot the bill for tax expenditures and transparency is key to informed decision-making for both Congress and taxpayers. The tax expenditures I analyzed in *Billion Dollar Blind Spot* collectively cost taxpayers more than $270 billion over a 5-year period, but we have no existing data as to whether that money is well-spent when it comes to women-owned firms accessing capital. There is no data—other than my survey data—on how or whether women-owned firms benefit, if at all, from these provisions. Moving forward, Congress has spent at least $415 billion on Section 199A alone, and the latest research suggests that less than 1% of women-business owners will receive more than 50% of the revenue loss in 2024. At the same time, women-owned firms are 40% of all U.S. businesses, and Congress needs data to ensure its making tax-policy investments that will generate a return for taxpayers. Absence of data on women-owned firms and tax expenditures ensures that Congress will continue to be operating in the dark.

SENATOR DUCKWORTH QUESTIONS

I am working with community leaders in Cairo and Golconda in southern Illinois where Federal resources have been shuttered, leaving these communities with fewer people and less investment to re-start their economies. Rural communities like these may struggle to capture the full benefits of Opportunity Zones and New Markets Tax Credits, despite being eligible for the investments.

QUESTION 1: How would you recommend Congress amend the tax code to better incentivize small business entrepreneurs to begin or grow their businesses in rural, economically distressed areas such as Cairo and Golconda?

ANSWER 1: According to recent academic research, increasing access to affordable high-speed broadband internet would dramatically change the lives of families and businesses operating in rural areas. As opposed to programs such as Opportunity Zones and New Markets Tax Credits that provide access to capital when and if a designated rural area or business qualifies, regular and immediate access to domestic and international markets via the internet is a more immediate strategy to create opportunities for rural small business owners who struggle with high internet costs and slow service.

TESTIMONY BEFORE THE UNITED STATES CONGRESS ON BEHALF OF



Statement for the Record

Before the

Committee on Small Business and Entrepreneurship
United States Senate

Hearing on Expanding Opportunities for Small Businesses Through the Tax Code

October 3, 2018

NFIB
1201 F Street, NW Suite 200
Washington, DC 20004

Chairman Risch and Ranking Member Cardin,

On behalf of NFIB, thank you for the opportunity to submit this statement for the record of the Small Business and Entrepreneurship Committee hearing entitled, "Expanding Opportunities for Small Businesses Through the Tax Code."

As NFIB represents roughly 300,000 small and independent businesses across the country, we appreciate the Small Business and Entrepreneurship Committee's continued attention to how tax policy impacts small businesses.

For years, small businesses have counted tax issues among five of their top ten problems, according to NFIB's *Small Business Problems and Priorities* survey.[1] The recently-enacted *Tax Cuts and Jobs Act* (TCJA) presented the biggest tax overhaul in more than three decades, and it dramatically improved the landscape for many small businesses.

The centerpiece of these tax changes is the new Section 199A, or the small business pass-through deduction. This deduction is important because more than 90 percent of small businesses are organized as pass-throughs (S corporations, LLCs, sole proprietorships, or partnerships), not as corporations. Under the TCJA, a pass-through business owner – regardless of the type of business they own – can now claim a full 20 percent deduction on their share of the business's income up to $315,000 in 2018 for those filing jointly. For small business owners whose taxable income exceeds the threshold, the deduction is subject to formulaic limitations. The overwhelming majority of small businesses in America are eligible for this benefit. According to current IRS statistics, it is estimated that there are 23.7 million businesses in the United States.[2] Of those, over 23 million have net business income of $250,000 or less.[3]

Coupled with increased thresholds for the alternative minimum tax and estate tax, a doubling of the standard deduction, and a significant increase in the expensing limits, the benefits to small and independent business owners are substantial.

These improvements to the tax code afford significant opportunities to small business owners. The much-needed savings provide more capital to invest in growing, hiring, and producing. Since enactment of the tax law, the tangible effect has been remarkable and historic. According to NFIB's monthly *Small Business Economic Trends* survey,[4] small business owners are notably confident about the economy. The NFIB Small Business Optimism Index has remained high throughout the last 23 months – a historic positive trend – with a reading of 107.9 in September, the third highest reading in the survey's

[1] Holly Wade, Small Business Problems and Priorities, NFIB Research Center, (August 2016), available online at https://www.nfib.com/assets/NFIB-Problems-and-Priorities-2016.pdf.
[2] Treasury Office of Tax Analysis, "Methodology to Identify Small Businesses and Their Owners" Technical Paper 4, at 10-14 (Nov. 2016).
[3] *Id.*
[4] William C. Dunkelberg and Holly Wade, NFIB Small Business Economic Trends, NFIB Research Center, (August 2018) available online at https://www.nfib.com/assets/SBET-Sep-2018.pdf.

45-year history. This year has produced 45-year record high measures of job openings, hiring plans, actual job creation, compensation increases (actual and planned), profit growth, and inventory investment. The record-breaking figures are driven by small business owners executing on the plans they have put in place due to significant changes in the nation's economic policy.

To put these reforms and subsequent opportunities for small business owners in context, consider David Cranston. He owns a small material handling equipment business outside of Pittsburgh with seven full-time and two part-time employees. In testimony before the Senate Finance Committee[5] in late April, he detailed just how important the tax law and, specifically, the pass-through deduction are to his business.

Cranston noted, "I now qualify for a 20 percent deduction on my pass-through income. In real terms, this means I will be able to keep $5,000 to $10,000 a year in my company. This is a big deal to a small business owner like me."

These savings will allow Cranston to expand into a new product line. Cranston's business is purchasing new equipment, investing in training, and building a new website to self-fund this new product line.

Cranston's experience is far from unique. On May 17, 2018, NFIB released a survey titled *Small Business Introduction to the Tax Cuts and Jobs Act (Part 1)* to provide a baseline reading on small business owners' initial responses to the TCJA.[6] The survey, the executive summary of which is attached as an addendum to this statement for the record, found small business owners are bullish about business and the impact of the TCJA:

- The vast majority (76 percent) of small business owners believe the current business climate is heading in a positive direction.
- Three-fourths of small business owners believe the tax law will positively impact their business.
- Eighty-seven percent think the new tax law will have a positive impact on the general economy.

The majority of respondents anticipate a lower tax bill next year and plan to allocate the extra money across a number of business activities. Among these small business owners:

- Forty-four percent plan to increase employee compensation.

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[5] Senate Finance Committee hearing, "Early Impressions of the New Tax Law" (April 24, 2018), testimony available online at https://www.finance.senate.gov/hearings/early-impressions-of-the-new-tax-law.

[6] Small Business Introduction to the Tax Cuts and Jobs Act: Part 1, NFIB Research Center, (May, 2018), available online at https://www.nfib.com/assets/TCJA-Survey.pdf.

- More than one-quarter (27 percent) plan to use the extra savings to add employees.[7]

Certain specific benefits stand out for small business owners:

- Overwhelmingly, 84 percent of small business owners view the creation of Section 199A as important.
- Eighty-five percent consider the reduction of individual rates as important.
- Two-thirds regard the changes to the estate tax as important.
- Seventy-six percent of small business owners view the doubling of the standard deduction as important.[8]

Unfortunately, these key provisions expire after 2025. This complicates long-term planning for small business owners. NFIB urges Congress to make these critical provisions permanent, thereby providing certainty and lasting tax relief to small business owners across the country.

[7] *Id.*
[8] *Id.*



Small Business Introduction to the Tax Cuts and Jobs Act: Part 1

May 2018

Executive Summary

- Over three-quarters (76 percent) of small business owners believe the current business climate is heading in a positive direction (Q#4).

- The vast majority (87 percent) percent of small business owners think the new tax law will have a positive impact on the general economy. Just 4 percent believe it will have a negative impact and 9 percent think it will have no significant impact (Q#14).

- Three-fourths (75 percent) of small business owners believe the tax law will positively impact their business, 22 percent anticipate it will have no impact, and 3 percent a negative impact (Q#12).

- While small business owners are enthusiastic about the law generally, many of the details are still unfamiliar to them. Almost one-in-four (24 percent) percent of small business owners are not at all familiar with the new tax law (Q#7).

- Half of small business owners with some familiarity about the law obtained their most useful information from their tax preparer or advisor, another 28 percent from the general news media (Q#8).

- Over half (51 percent) of small business owners expect to pay less in federal income taxes next year, 7 percent expect to pay more, and 37 percent about the same (Q#15).

- Almost half (47 percent) of small business owners who expect to pay less in taxes next year plan to increase business investments with their tax saving (Q#15a5) and 44 percent plan to increase employee compensation (Q#15a6). Another 40 percent of small business owners plan to pay down debt obligations (Q#15a7), 32 percent plan to retain the funds freed up as higher earnings available to support business growth (Q#15a4), and 27 percent plan to hire an additional employee (Q#15a3).

- Over half (55 percent) say that the creation of Section 199A, allowing for up to a 20 percent small business income tax deduction, is "very important" with another 29 percent "somewhat important" (Q#20B).

- Forty-five percent of small business owners say that changes to the personal income tax brackets and rates are "very important" to them and their business, 40 percent say "somewhat important" (Q#20A).

National Small Business Network

TCJA Corrections for Economic Sustainability

Policy Recommendations for the 115th Congress - October 2018

In December of 2017 the Congress passed the Tax Cuts and Jobs Act (TCJA) which included many major tax policy changes. We believe the legislation did not achieve the objectives of good revenue neutral tax reform and needlessly added to the federal deficit, with potential long-term economic consequences. Before considering proposals to extend to provisions, Congress should instead work to correct and improve them

The following recommendations for corrections and additions to the TCJA, are suggested as part of a balanced program of both tax policy and budget policy actions to restore a sustainable Federal fiscal process. The detailed recommendations build on many of the concepts developed by prior House and Senate working groups, and other tax reform advisory groups. They focus primarily on business tax reform issues, particularly for small and mid-sized businesses, because those will have the greatest impact on job creation and general economic growth.

To support sustainable economic growth, we believe that good tax code reform should meet these basic principles:

- **Simplify and coordinate of our overly complex tax code to reduce both taxpayer and IRS administrative expense, and improve compliance.**
- **Provide equitable tax incentives for the growth of small businesses that provide over half of all new jobs. These are predominantly pass-through entities which require separation and equitable treatment of the net business income in the personal tax code.**
- **Incentivize direct long-term investment in businesses, buildings, and equipment that create new jobs, rather than short-term speculative transactions which may increase individual wealth, but create no new economic activity or jobs.**
- **Promote domestic investment and job creation to the greatest extent possible within the limitations of international agreements by focusing tax preferences on domestic investment.**
- **Increase US international business competitiveness, and also reduce the ability of multi-national corporations to avoid taxes by shifting profits under a territorial system to lower tax rate countries, by taxing all multi-national corporations on the basis of their US sales and impacts, the way states tax multistate corporations.**
- **Assure that any tax reform is at least revenue neutral and provides adequate overall revenue to gradually reduce our national debt and restore long-term fiscal stability.**

1. Deficit financed tax cuts at a time of relatively strong economic growth were not the solution to sustainable economic growth. The GAO and CBO have concluded "The federal government is on an unsustainable fiscal path" with spending exceeding revenue by $895 Billion in the first 11 months of this fiscal year, with the projected debt growing to 100% of total GDP in just 12 years. Most economists believe that continuing deficits and our growing $18 Trillion national debt will reduce long-term economic growth, and are a very real threat to the future sustainability of our economy. We agree with the GAO recommendations, and those of other study groups. See our more complete Fiscal Policy Recommendations on our website at www.NationalSmallBusiness.net .

Our overall tax level is not the cause of our current economic and under employment problems. The total US average Federal, State, and local tax burden is the forth lowest of all 34 OECD countries at 25.7% of GDP. Only Korea, Chile, and Mexico have lower average rates, and the average of all other OECD countries is 34.1% of GDP. With the exception of payroll taxes, most American businesses pay Federal taxes only when they are profitable. The current federal tax level on individuals and "pass-through" business entities is lower than it was during times of economic prosperity and growth, and is lower than most other leading industrial nations. The stated tax rate on large corporations was higher than other nations, but when adjusted for US business tax incentives and other taxes imposed by foreign countries, such as value added taxes, it is similar to other leading industrial nations. Even during a time of high corporation earnings, corporation income tax revenues have fallen from 5% of gross domestic product in 1952 to only about 1.9% today and will fall further with the lower TCJA rates.

2. Many of the 2017 TCJA provisions did not adequately meet the criteria for good tax reform legislation, particularly the goal of tax simplification, and may have long-term negative economic consequences. Rather than making the TCJA changes "permanent", Congress should focus on clarifying, correcting and improving them.

A. Business tax code changes:

100% Bonus depreciation, or immediate expensing, of long-term capital investments was not needed:
Although accelerated expensing can be a useful tax tool during a recession, its use at the peak of an economic cycle was not needed and significantly. It increased the federal deficit and growth of the debt, which will have future negative economic consequences. Even more importantly, when the next recession happens, the Congress will have no practical tax incentives left for stimulating the economy when needed. The Federal Reserve, which has been massively stimulating the economy for the last 9 years, with very low interest rates and monetary expansion, is also still in a weak position to provide emergency stimulus when another major recession occurs. There are signs that the next recession is not far away and will probably be worldwide. Congress should shorten the phaseout of this provision.

Correct the drafting error in the depreciation provisions which eliminated the provision for restaurants and retailers to depreciate qualified improvement property over 15 years rather than 39 years. The more realistic depreciation period for more frequent renovations is important to small businesses and should be restored.

The 40% Higher Tax rate on high potential growth C corporation startups will hurt economic growth.
Congress has always said that they understand the contributions small businesses to the economy, yet the TCJA elimination of graduated rates on small C corporations actually increased the tax rate for small startups by 40%. This is a result of deleting the lower 15% tax bracket on the first $50,000 of income. Most high growth potential start-ups, who may become the base of the future economy, are organized as C corporations because of the need to attract equity capital for growth. Based on 2013 IRS statistics, the most current available numbers, approximately 556,400 small business are in this category and will have their taxes increased. We recommend legislation to reinstate the lower 15% tax rate on business income below $50,000 and provide graduated rates between $50,000 and $10 M of corporation taxable income.

B. Pass-through entity complexity issues from the Section 199A deduction

Although it was important to provide an equitable tax reduction for pass-through businesses to balance the corporate tax rate reduction, the 199A "deduction" was poorly coordinated with prior tax policy and poorly written. There are many unanswered questions and undefined definitions and calculations. The IRS has attempted to clarify many of the issues with temporary regulations issued in July, but other issues may require additional regulations or legislative correction and clarification.

1. Is it equitable to exclude true business income from the designated professions such as health care, accounting etc. if a single taxpayer is over the $157,000 income limit and a married taxpayer is over the $315,000 income limit? Wouldn't it rather be better to develop balanced provisions for all business types that separate "personal" business activity which should be taxed as wages, from business income resulting from return on capital investment and the wages of others? This is also true since there is no longer a higher C-corporate rate for these types of entities.
2. The regulations acknowledge that common law employees include lease employees, but partners who receive guaranteed payments working in their capacity of an "employee" are excluded from the wage calculation. The Service said that it wanted to write regulations so as to not require businesses to change their entity type. By disallowing payments to partners, they are in fact requiring the partnership to change form.
3. How are various businesses and various rental properties to be aggregated with relationship to their selves and each other and how is the IRS "related activity" test to be applied?
4. Rental Real Estate
    a. What qualifies as a rental real estate business?
        i. If it rises to a business, will it be subject to payroll or self-employment taxes or excluded under Section 1402 as rental property?
        ii. What if it is a net, net lease?
5. Is the rental of tangible personal property qualified business income?
6. What is depreciable property under Section 199A 199A(b)(2)(B)(ii)?

a. Under the IRS de minimis rules, we can elect to expense any item costing under $2,500 in the year of purchase. If we make this election, do we lose the ability to add them to our asset calculation under this section?
b. If the taxpayer takes bonus depreciation under Section 168(k) or Section 179, will that effect the ability to include the asset in the asset calculate?
c. Under Section 199A (b)(6)(B)(ii), inclusion in this section is limited to property that is being depreciated for the full year. Therefore, where depreciation for property placed in service is determined based on the month it is placed in service and the property was not place in service in January, will the property not be included in the final year.

7. How does qualified business loss interact with qualified business income and a net operating loss?
8. How are passive income and passive loss activities going to interact with qualified business income and qualified business losses and net operation losses?
9. How are allocation of wages and depreciable basis going to allocated to partners who are receiving special partnership allocations?
10. How will 199A work with publicly traded partnerships?

Other issues:

Membership Dues
Are dues paid to business organization such as trade associations and business organizations such as the Chamber of Commerce still deductible?

2. The TCJA also eliminated or reduced several personal tax expenditures to generate offsetting revenue, but these tax expenditures should be reconsidered.

Tax law, including tax expenditure incentives, can be a major factor in economic decisions by both businesses and individuals. Tax policy is also one of the few remaining strategic tools to provide targeted economic incentives for domestic economic growth, or emergency stimulus during recessions. Businesses and investors often focus on short-term profit, rather than on the long-term sustainability of their business; the health of the national economy; or concern for the environment. Tax policies that overly "broaden the base and reduce the rate" limit the ability of Congress to provide strategic incentives for long-term economic sustainability and international competitiveness. Flat tax structures tend to encourage short-term speculation instead of long-term direct investment. They also encourage movement of investment capital anywhere in the world where the potential return is highest.

Reducing most current tax expenditures in order to reduce maximum tax rates probably also increases the effective tax burden on middle income and small business taxpayers while reducing tax revenue from large corporations and the very wealthy. Most tax expenditures, including deductions, credits, and preferential tax rates are limited either by specific maximum amounts, or maximum overall income levels for which the provisions apply. These limits are in place to

obtain the greatest economic or social policy affect with the least loss of tax revenue, and often have the greatest incentive effect and benefit for middle income taxpayers.

The $10,000 limitation on deductibility of State and Local taxes will make it more difficult for school districts to pass funding measures for better education systems and for cities and states to fund better public safety and infrastructure programs. These are serious problem areas where the federal government provides little funding or support and local citizens should be incentivized to solve them without having to pay a "tax on a tax" for income they never actually received. The provision also implies that the federal government is better able to determine what services taxpayers really need better than their local governments, which is not supported by any evidence.

The SALT deduction limitation is also particularly harmful to small business owners. Most small business are pass-through entities and have to pay the state income tax on their business income, which can be as high as 10% in some states, on top of the taxes on their personal income and property, probably making all of the tax on their small business income non-deductible. We recommend that if the cap on personal state and local taxes is not increased, that small businesses be allowed to deduct at least the first $50,000 of state income tax on their business income, in addition to the personal cap.

Another deduction eliminated by the TCJA was the deduction of employee business expenses. With the changes in technology and the workforce more employees are working outside of a conventional business location and are being required by employers to fund more of their own expenses for equipment, transportation and even work space. Since these required costs reduce their effective income, they should be deductible against the income, just as they would be allowed for a self-employed contractor.

Existing Congressional data does not provide adequate decision-making data for Congress to accurately evaluate existing tax expenditures, deductions, and rate preferences. We recommend that the House and Senate Budget Committees and Senate Finance and House Ways and Means Committee jointly request the CBO or JCT to develop a current comprehensive analysis of the actual economic benefits of all tax expenditures.

General Tax Policy Recommendations for Future Reform

3. Tax Simplicity, Clarity, Equitability, and Efficiency Recommendations:

One of the key goals of tax reform was to simplify the complexity of the current code, and provide greater tax system clarity and equitability for different taxpayer entities. The TCJA actually complicated tax calculations by implementing the poorly conceived and poorly written Section 199A. The current code, which was built on successive layers of changes by past Congresses, has become too complex with too many adjustments, limitations and phase-outs for taxpayers to understand and comply with. Many provisions either purposely or unintentionally negate or limit the effects of other provisions. Other provisions have become outdated by changes in technology or business practices.

A. Increase the role of the Joint Committee on Taxation, Treasury Tax Policy and the IRS in assisting Members of Congress in the ongoing development of a simpler and

better-coordinated federal tax code. Complexity makes it difficult for taxpayers, and even professional tax preparers, to understand and comply with the code. Complexity also increases the administrative burden on the IRS and makes it difficult for them to provide good taxpayer assistance and improve filing accuracy and taxpayer compliance. Often the IRS has to resolve legislative issues with hundreds of pages of detailed regulations which increases the administrative burden on the IRS, and often just further increases complexity for the taxpayer. The Congress should direct JCT, Treasury and the IRS to develop a joint working group to identify existing code issues requiring better legislative clarity or coordination, and a process to develop legislation to resolve them.

B. Continue to revitalize the management and business systems of the Internal Revenue Service to provide better taxpayer assistance and an efficient and equitable administration process. The ability of the IRS to properly and efficiently administer the tax code is currently hindered by incomplete improvements to vital business systems such as data processing and communication technology. The IRS is also facing increased administrative responsibilities, such as the ACA and FATCO, combined with declining budget allocations, and heavy turnover of key staff. With budget cuts, training has been reduced and staff expertise has declined. This is resulting in declining levels of performance in many areas and increased burdens on taxpayers and return preparers. The combination of a complex tax code, declining taxpayer assistance, inadequate IRS budgets, and reduced IRS training and staff levels will eventually threaten accurate and equitable enforcement of tax laws. If this happens, it will also reduce collection of the revenue needed for all other Federal programs and services.

Congress and the Administration need to recommit to the goals of the 1998 IRS Reform and Reorganization process by providing funding for better taxpayer assistance, support for improvements to technology systems, and stronger management emphasis on business process re-engineering for greater efficiency in the tax administration process. The IRS needs increased Congressional budget support and better proactive communication on agency issues. The Administration and the Senate also need to complete the revitalization of the IRS Oversight Board, rather than eliminating it, with additional nominations, to assist IRS management with continuing organizational improvements and improving communication with the Congress.

C. Provide standard tax code definitions and coordinated inflation adjustments for all limit and rate bracket provisions. Multiple definitions exist for many items of income and types of credits and deductions. These need to be standardized and simplified. Congress needs to review the Internal Revenue Code for fixed limitations and provisions, which are long overdue for inflationary adjustments, such as the business gift limitation, and update them. Then, adopt a standard inflationary adjustment provision to replace the myriad of specific provisions in the code for rate brackets and all dollar limitations which should have periodic adjustment. The provisions should require a reasonable minimum inflation change before a periodic adjustment is made. We also support the tax clarity and simplification recommendations of the American Institute of Certified Public Accounts Tax Policy Committee.

F. Simplify state income tax nexus issues for out-of-state businesses by adopting a modernized federal limitation on non-nexus state income and business activity taxation, of both services and products. This should include digital products delivered from outside a

state via public carriers and electronic transmission by businesses without state nexus. Modern electronic technology has greatly increased the ability of even small businesses to sell services nationally without any physical nexus in a state. Unfortunately, this increased capability, combined with increased legislative and enforcement activity by revenue starved state governments, is creating significant state income tax nexus problems for businesses.

Complying with out of state income tax or "business activity" tax laws for a small amount of out of state income often subjects small businesses to significantly higher accounting and tax preparation expenses, and a higher total tax liability

G. Pass marketplace fairness legislation to facilitate each state's right to use sales and consumption taxes, and simplify retailer remittance of interstate consumption taxes.
The Supreme Court's Wayfair vs South Dakota decision clarified the right of states to require out of state sellers to collect state sales taxes, but created major new problems for both the states and retailers. Congress should support effective and efficient interstate, and international, collection of state sales and use taxes. Market Place Fairness legislation would provide an equitable business environment for those businesses that properly collect state sales taxes. A federal interstate sales tax administration legislation would not create any new taxes, but would simply enable states that have chosen to use consumption-based taxes to efficiently collect them on the growing volume of internet purchases. Because an increasing volume of internet direct to consumer sales are originating from outside the US, the Congress should also consider international agreements and other actions that can help states collect use taxes on foreign direct sales.

4. Capital Gains Tax Reform Recommendations:

Congress should encourage long-term direct capital investment by adjusting the calculation of long-term capital gain, on assets held more than 10 years to remove taxation of the phantom gain from monetary inflation, and properly reflect the true constant dollar value of the gain. But, the provision should only be applied to direct economic investment in businesses, property, or business equipment, not in traded securities or other speculative investments that do not produce new economic activity.

Calculation of the adjustment would be simple, and require only a multiplication of the dollar gain using IRS supplied existing data on the cumulative inflation change from the year of purchase to the year of sale.

The current personal income tax code provides a lower tax rate for a "long-term capital gain" on an asset held for more than 365 days. This actually progressively penalizes longer-term investments that are held more than one year because of the failure to adjust for monetary inflation over the investment life. The investments that America needs to build a sustainable economy by starting or growing businesses, and building business infrastructure, are not 366-day investments. True long-term business investments may not provide a capital return for 10, 20, 30, or 40 years or longer. Even owners of relatively small businesses will generally be in the maximum rate bracket in the year they sell their business or business property resulting in taxation at the maximum rate. Most states also add an additional state tax of up to 10% on capital gains, based on the federal calculation.

The current law also provides the same tax treatment for individuals who invest in speculative secondary market investments such as traded stocks. Except for new offerings, traded stock purchases create no new economic investment or funding for business growth. Ironically, secondary economic investments actually have a greater tax benefit because they can be easily sold after 1 year when the tax benefit is greatest. Where the asset is a business or investment property, this short tax incentive peak encourages the owners to focus on short-term "paper" profitability and the potential for resale, rather than long-term growth and sustainability. The 366-day incentive peak also encourages financial speculators to purchase and sell off asset rich businesses, rather than operating and growing them.

Almost all other value comparisons that extend over long periods such as economic statistics, government budgets, and other tax code provisions, are adjusted to remove the artificial effect of inflation. Although compensating for some inflation distortion is part of the justification for having a lower tax rate on capital gains, this is a classic case where a "one size fits all" approach does not work.

Based on the last 40 years of inflation, the Federal taxes alone would actually exceed the total real economic gain on the sale of an asset after about 40 years at a 23.8% tax rate. State Capital Gains Taxes, which are usually based on the federal calculation, can also add up to 10% additional tax on the inflationary increase. Although an adjustment should be made on assets held for more than 10 years, the scoring cost of correction legislation could be reduced by limiting the adjustment to business property or direct business investments where the taxpayer is an active participant. Potential revenue offsets for an inflation adjustment include increasing the "long-term" capital gains holding period to 2 or 3 years, or slightly increasing the capital gains tax rates.

5. Other issues

A. Permanently equalize the deductibility, up to a reasonable cost limit, of individual or group health insurance at the entity level for all forms of businesses.

For the year 2010 ONLY, the Small Business Jobs Act of 2010 finally allowed self-employed taxpayers, and partners, to deduct the cost of their health insurance, without paying payroll taxes on the insurance cost, as all corporations can. The equal and simple deductibility of group health insurance regardless of the legal form of business entity has been a key issue for small businesses for many years. Prior Congressional action partly corrected this problem for S Corporation stockholders, but 21 million self-employed individuals are still required to treat the expense as a non-business expense even if they provide identical coverage for their employees. This results in the taxpayer paying an additional 15.3% on the insurance expense. Because of their small group sizes, the self-employed already pay the highest relative insurance rates. This inability to deduct their own insurance has always been an emotional disincentive for small business owners to provide group health insurance for their other workers.

B. Provide equitable employee cafeteria benefit options for small business owners.
Small businesses compete for workers with large businesses and the public sector. Because of differing family situations, differences in benefit options available through other family

members, or because of personal preferences, many employees often want different benefits than fellow workers.

The 2010 PPACA Health Care Bill included provisions for a simplified Cafeteria Plan. However, current restrictions make them unattractive for most small businesses, other than C corporations, because business owners cannot be part of the plan. Current law specifically prevents sole proprietors, partners, and sub chapter S corporation shareholders from participating in a cafeteria benefit plan. These limitations discourage small businesses from offering employees a very logical form of employment benefit and make small businesses less attractive for prospective employees.

C. Modernize and simplify the qualified home office deduction to allow de-minimus personal use and the conduct of business with clients using electronic technology.
The TCJA eliminated deductibility of all employee business expenses. Therefore, this deduction is no longer allowed to employees who are required to work from their home. This should be reinstate along with other employee business expenses.

Currently, home-based businesses represent about 52% of all American firms and generate 10% of the country's total GDP, or economic revenue based on SBA research. In the future, that percentage is likely to grow as new technologies and the Internet make new business models possible and increase the ability of people to work remotely.
In 2012, the IRS provided a regulatory standard for a simplified home office calculation with a maximum deduction of $1500, but could not address some the basic statutory limitations of the existing code without Congressional action. Internal Revenue Code Section 280A(c) (1) defines the requirements that must be met to deduct home office expenses. It generally permits a deduction for a home office in a taxpayer's residence only if it is used "exclusively on a regular basis. This is a much higher standard than required of regular business or governmental offices The code also requires the office to be "used by patients, clients, or customers". This language in the code has been interpreted by the IRS to require clients or customers to be physically present in the home office. Today, many businesses do business with their customers without any physical presence. It is both unrealistic and unreasonable not to also allow some de- minimus personal activity in an otherwise qualified home office area and to allow the use of digital business practices. Congress should make these changes by statute..

D. Increase the deductibility of business meals for small businesses up to 75%.

As stated earlier, TCJA eliminated any deduction for entertainment and meals other than business meals. The 1995 White House Conference on Small Business identified the importance of the business meal deduction to the success of small business. They often do not have appropriate space at their business to meet and work with important clients, referral sources or suppliers. Large businesses often have meeting and conference rooms at their facility that are often tax deductible. Small businesses, particularly home-based businesses, may have only their kitchen table. They often have to use restaurants as an opportunity to prospect for business and to complete transactions with clients. Other existing code provisions properly limit excessive meal expenditures.

E. Simplify the matching of third party payment reporting on Form 1099 K by correcting the law to require NET income reporting.
Congress made a technical error in the legislation *requiring* third party payment processors to report annual proceeds as an enforcement provision on a gross basis. The IRS has tried to work around this flaw in the legislation by building average estimates of what percentage of net income might result from gross transactions, but many businesses are not "average", and it is resulting in too many "false positive" examinations.

F. Return the contribution due date for IRA investments to the extended return due date.
Prior to the Tax Reform Act of 1986, standard IRA contributions, like all other retirement plan contributions, were permitted up to the earlier of the extended due date of the return, or when the return was filed. Their due date is now April 15, with no extensions. This causes a burden on taxpayers who have to make IRA contributions at the same time that both prior year final tax payments and their current year first quarter estimated tax payment are due.

G. Make permanent the TCJA increased Federal Estate Tax exemption to allow better long range estate planning, and protect mid-size family businesses and farms, but do NOT repeal the Estate Tax.
The current estate tax exemption of about $11 Million per person, or $22 Million per couple is adequate to protect 99% of small family businesses and farms from a federal estate tax impact. However, the estate tax is still an important business continuity issue for faster growing mid-size businesses and larger farms because of rising land values. The Estate tax should not be repealed though, because far more small businesses and farms would be hurt by high capital gains taxes when the businesses are sold to children or others, without the step-up in basis as part of the current Estate Tax.

6. International Corporate Tax Policy Recommendations:

We believe Congress erred in adopting a territorial tax system for multinational corporations combined with lower tax rates as a way to make US businesses more competitive. The reduction of corporation taxes rates by other nations has been a race to the bottom, with a significant loss of tax revenue from businesses. Adoption of a territorial system, even with base erosion provisions will actually make permaent the incentive to move business activity to lower tax countries. We believe the Congress should work with other nations to change the taxation of multi-national businesses (MNB) to a formulary allocation system based on their percentage of sales in each country, to remove the incentive for profit shifting to lower tax countries and for corporate inversions. This would put US businesses on the same tax allocation basis as foreign owned multinational businesses with US taxable income and remove some or all of the US income tax cost burden on exported goods.

The current corporate income tax system allows multinational corporations, particularly those with high intellectual property values, to use inter-division accounting manipulations to shift taxable profits to divisions in lower tax countries where the earnings can multiply. This not only reduces US tax income, but also creates a tax incentive barrier to recognizing and re-investing those earnings in the US for domestic business growth. When intellectual property

is developed with US Research and Development tax credits and protected and given value by the US Patent system, the profits from that research should be taxable in the US.

The US should instead tax the profit of US Corporations from all their controlled foreign business subsidiaries and other investments on the world-wide" basis. The worldwide taxable profit, and any tax credits, should then be apportioned on the basis of the percentage of final sales, or a combination of sales, assets, and employment in the US. There should have been no reduced tax rate on repatriated profits because a lower rate would provided no new economic incentives, since the profits are from prior year's sales. Repatriation will probably also not result in any major US economic benefit from new domestic corporate investment based on economist analysis. Analysis of the last voluntary repatriation incentive found the funds were primarily used for increased dividends and stock buy-backs. The tax rate on repatriated profits does not affect current business competitiveness and businesses have already applied the credits for foreign taxes paid against other income.

Allocating taxation of profits based on the location of sales or other factors has long been used to allocate profits of national businesses between the states. Currently 21 states use a single sales factor for allocating taxable profit and 17 states use a double weight sales or other factors allocation formula. It is also a logical way, with careful limitations and interaction with other countries, to allocate taxable profits internationally. Taxing on the basis of national sales would remove the incentive for profit shifting by multi-nationals. It would also discourage the game of countries bidding down their tax rates to attract tax shifting and allow them to increase revenue for their countries.

Formulary Allocation (FA) would be the simplest of "border adjustable" options, with few transition or regulation issues, and no negative impacts on domestic businesses. It would utilize the existing US corporate tax code and international accounting standards, up to the final step of per country allocation. MNBs, with US tax nexus would calculate taxable income on a worldwide basis, but only pay US income tax based on their percentage of sales, or other economic impact factors, in the US. FA meets the stated bi-partisan Congressional objectives for international tax reform, including removal of US income tax cost on American exports.

FA would make it easier for corporations to correctly calculate their US taxes, and for the IRS to accurately audit them since it would more closely match the unified reports MNBs produce for financial reporting purposes. The US states, and political subdivisions in some other countries, have used a sales factor, or multi factor allocation system including sales, employment, and assets, for many years. Most multi-national corporations with US state nexus already report their state income tax liability on that basis now. The US already taxes multinationals on a worldwide basis, except for foreign headquartered corporations, who are treated on an activity nexus basis very similar to the way they would be treated under a formulary allocation system. Although there is some potential for misrepresenting sales destinations, the rules used by the states should provide a good basis for accuracy.

FA removes the incentive for profit shifting" to lower tax countries by dividing total world-wide profit to be taxed based on a fairly clearly definable percentage of sales, or other factors, by country. Businesses would not want to reduce sales in the US, regardless of the tax rate. FA also removes the incentive for corporate inversions by taxing both domestic, and foreign corporations that have US tax nexus, on the same percentage of sales basis which should

meet WTO standards for equal treatment.

FA removes the need for the US, and also for other nations, to try to "bid down" their corporation tax rates to undercut other countries and encourage profit shifting and asset relocation in their direction. If FA was adopted by other countries, it would also allow them to return their tax rates on MNBs to higher levels without losing revenue due to profit shifting.

FA would not be a "New Tax" that could be blamed on either political party. And FA is inherently border "adjusted". It would remove some or all of the US federal income tax cost from goods sold outside the US, making them more competitive. FA would also not disrupt most state corporate income tax systems, which are generally based on the current federal corporation code with formula allocation of unitary profits just as the federal tax would be. FA would give US multinational businesses permanent tax relief on export sales, rather than allowing permanent tax avoidance from MNB profit shifting, under a territorial system.

Although a detailed analysis is needed, FA could also increase overall US corporation tax revenue, based on historical data, while reducing tax avoidance and broadening the tax base, without creating a disincentive for US manufacturing and investment due to comparative tax rates. JCT should be asked to do an analysis using the most current and projected data, but FA would appear to be revenue positive after elimination of Section 199 credits, foreign income tax credits, and the revenue loss from deferral of recognition. The increased tax revenue could be used to reduce the corporate tax rate, or pay down the deficit. If JCT analysis is not revenue positive, the Congress could also just significantly reduce the corporate tax rate on the percentage of export sales, rather than fully eliminating the tax.

7. New Revenue Balancing Options

A Value Added Tax: The size of the national debt and annual budget deficits in relation to current income tax revenues makes it unlikely that Federal income taxes alone could pay down the debt, even if quickly returned to previous levels. Even if the House and Senate switch to Democratic control in 2019, the likelihood of any significant income tax increases overcoming a Presidential veto in the next 2 years is probably nil.

The only additional revenue generator with the potential to stabilize and reduce the deficit in conjunction with the income tax is probably a Value Added Tax. During the tax reform debate, many Republicans showed an interest in moving to a "consumption tax" and to also allow a refund of the tax on US exports, to promote international economic competitiveness. A VAT meets those requirements far better than previous Republican proposals, and even at low rates has the potential to generate significant revenue, with relatively low complexity and lower potential for tax avoidance in an increasingly less "traceable" and international economy. We recommend that the Finance and Ways and Means Committees start a bi-partisan review of value added taxation as a potential supplement to the income tax. Because consumption taxes tend to be regressive in impact, some adjustment may need to be made to income taxes to off-set the impact on lower income citizens.

An "Automatic" Budget Balancing "Fail-Safe" Act: Because of the very high level of partisanship that currently exists in the Congress it will be very difficult for either party to take any leadership in balancing the budget by increasing taxes or reducing major expenditure programs. The only possible way to get agreement on increase revenue may be through bipartisan pre-agreement on an "automatic" deficit control process similar to prior "paygo" and budget sequestration laws, which weren't perfect, but helped control deficits without either party having to take the pollical "blame" for the necessary action. Congress should first try to balance expenditures with adequate tax revenue to pay for them using regular order and the process improvements suggested earlier. But as a "Fail-Safe" to prevent deficits except in times of national economic emergency, we suggest the Congress adopt a provision which would provide for automatic income tax rate increases necessary to offset any prior budget year deficit.

> Within 60 days of the end of each Federal fiscal year, the Congressional Budget Office would send to the Congress, a Budget Reconciliation Report listing the estimated amount of all federal expenditures and all estimated Federal revenue for the preceding fiscal year. If the estimated expenditures exceed the projected revenue, the report shall specify the amount of the deficit which will be collected under the Act as adjustments to the following years specified tax rates.
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> Within thirty days after a determination by the Congressional Budget Office that a revenue deficit existed for the prior fiscal year, the Department of the Treasury shall send to the Congress a determination of the uniform percentage of increase in tax rates for corporations; Individuals; heads of households; unmarried individuals other than surviving spouses and heads of households; married individuals filing jointly; married individuals filing separate returns; estates; and trusts that would be needed to collected the deficit amount.
>
> Sixty days after the Congress receives notice of an automatic rate adjustment percentage determined by the Department of the Treasury, the rate adjustments would then be added by law, to the currently adopted tax rates for each income tax category for following calendar year, unless the Congress approves by a 60% majority vote of both houses a "Declaration of Economic Emergency Requiring Deficit Financing" to rescind or reduce the automatic tax rate adjustment. At the end of the following fiscal year, any revenue collected as a result of an automatic rate increase which exceeds the amount the original CBO determined deficit for the prior year, shall be used to reduce the outstanding national debt.

These recommendations were prepared for the National Small Business Network by Eric Blackledge and Thala Rolnick CPA.

The NSBN is a nonprofit group that evolved from the 1995 White House Conference on Small Business Regional Tax Issue Chairs and do not represent the interests of any other organization or business.

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