NATIONAL TAXPAYERS UNION

April 18, 2023

The Honorable Roger Williams
Chair, House Committee on Small Business
2361 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Nydia Velázquez
Ranking Member, House Committee on Small Business
2069 Rayburn House Office Building
Washington, D.C. 20515

Dear Chair Williams, Ranking Member Velázquez, and Members of the Committee:

On behalf of National Taxpayers Union (NTU), the nation's oldest taxpayer advocacy organization, we thank you for holding this important hearing on the effect federal tax policies and tax administration have on America's small businesses. In an increasingly uncertain, complex, and global economy, federal policymakers should be doing everything in their power to provide tax and regulatory certainty to entrepreneurs and their employees. There are bipartisan paths forward to doing so, and there are also policies Congress should avoid enacting that would do harm to small businesses and their workforce. We hope to discuss both in this written testimony, and hope you will give our views and perspectives consideration.

About National Taxpayers Union

NTU is the nation's oldest taxpayer advocacy organization, founded in 1969 to achieve favorable policy outcomes using the most effective pro-taxpayer team on Capitol Hill and in the states. Our team has gained a reputation for its expertise on matters of tax administration, pro-growth tax policy, and regulatory policy. We know all three issue areas remain of relevance and importance to the House Committee on Small Business, and its vital role in overseeing the opportunities and threats facing America's millions of small businesses.

Small Businesses Are Essential to the U.S. Economy

As of 2022, the U.S. was home to 33.2 million small businesses employing 61.7 million people – nearly half (46.4 percent) of all workers in the U.S.[1] Entrepreneurs face different levels and types of taxation depending on how they organize their business, but hundreds of thousands of small businesses employing millions of Americans were organized as C corporations in 2019 subject to the corporate income tax, while millions of businesses employing nearly 50 million Americans were organized as pass-through entities (S corporations, partnerships, and sole proprietorships) subject to individual income taxes on pass-through business income.[2] Millions of small businesses are also required to collect and remit sales taxes in 45 of 50 states and sometimes hundreds or even thousands of local jurisdictions, while almost every active small business has to devote time and/or resources to complying with tax law and understanding federal and sales tax administration.

[1] U.S. Small Business Administration Office of Advocacy. (2022). "2022 Small Business Profile: United States." Retrieved from: https://advocacy.sba.gov/wp-content/uploads/2022/08/Small-Business-Economic-Profile-US.pdf (Accessed April 11, 2023.)
[2] U.S. Census Bureau. (February 2022). "2019 SUSB Annual Data Tables by Establishment Industry." Retrieved from: https://www.census.gov/data/tables/2019/econ/susb/2019-susb-annual.html (Accessed April 12, 2023.)

In short, the tax code imposes significant financial and compliance burdens on small businesses around the country. Small businesses, especially sole proprietors, may be less equipped than large, publicly-traded corporations to handle the burdens of tax compliance. Without the armies of lawyers and accountants that large, profitable companies can afford to hire, some small businesses risk financial losses or even business failure as a result of the disproportionate tax (and tax compliance) burdens they face at the federal, state, and even local levels. Federal lawmakers – especially those serving on this Committee – should work together in the 118th Congress to eliminate barriers that prevent small businesses from growing and reduce tax compliance burdens for entrepreneurs.

Recent Tax Policy Changes Affecting Small Businesses

Congress has passed major legislation affecting the U.S. tax code several times in recent years, and many of the enacted changes have a direct impact on the nation's millions of small businesses.

Perhaps the most impactful recent changes were made by the 2017 Tax Cuts and Jobs Act. TCJA lowered the corporate income tax rate from 35 percent to 21 percent, bringing the U.S. rate more in line with its economic peers around the world[3] and significantly reducing tax burdens for thousands of small businesses organized as C corporations.[4] TCJA also created a temporary qualified business income (QBI) deduction, effective from 2018 through 2025, that allows individuals "to deduct up to 20% of their qualified business income (QBI) from their taxable ordinary income."[5]

Other changes to the individual and corporate sides of the tax code enacted in TCJA reduced small business (and small business owner) tax burdens:

- The across-the-board rate reductions, effective 2018 through 2025, have the effect of reducing taxes on pass-through business owners' business income;
- Higher alternative minimum tax (AMT) exemption thresholds, effective 2018 through 2025, may have the effect of reducing the number of pass-through business owners subject to the AMT;[6]
- Higher estate, gift, and generation-skipping transfer (GST) tax exemption amounts, effective 2018 through 2025, may reduce tax burdens on the decedents of business owners who pass a business and its assets on to family members when they die;

[3] In 2017, America's 35-percent federal corporate income tax rate was third highest among the Organisation for Economic Co-operation and Development's (OECD) 38 member countries. In 2018, America's new 21-percent rate was tied for 22nd; i.e., closer to the middle of the pack. For more, see: OECD.Stat. (2022). "Table II.1. Statutory corporate income tax rate." Retrieved from: https://stats.oecd.org/index.aspx?DataSetCode=Table_II1 (Accessed April 12, 2023.)

[4] In 2019, the U.S. Census Bureau estimated that there were 919,673 firms with fewer than 500 employees organized as corporations. These firms employed a total of 12.4 million workers. Not all would have paid the top rate of 35 percent before 2018, given the corporate income tax rate was graduated based on income. Still, we can safely estimate that thousands of these firms earned enough income to be paying rates higher than the 21 percent enacted in TCJA. For more, see: U.S. Census Bureau, February 2022. "2019 SUSB Annual Data Tables by Establishment Industry." Retrieved from: https://www.census.gov/data/tables/2019/econ/susb/2019-susb-annual.html (Accessed April 12, 2023.)

[5] Guenther, Gary. "The Section 199A Deduction: How It Works and Illustrative Examples." Congressional Research Service, Updated February 10, 2023. Retrieved from: https://crsreports.congress.gov/product/pdf/R/R46402 (Accessed April 12, 2023.)

[6] For more, read: Eastman, Scott. "The Alternative Minimum Tax Still Burdens Taxpayers with Compliance Costs." Tax Foundation, April 4, 2019. Retrieved from: https://taxfoundation.org/alternative-minimum-tax-burden-compliance/ (Accessed April 12, 2023.)

- A temporary allowance of 100 percent bonus depreciation (i.e., full expensing) for businesses' investments in certain short-lived assets, such as machinery and equipment, has the potential to reduce small business tax burdens in the year they make those investments; 100 percent bonus depreciation begins phasing down 20 percentage points per year in 2023 until it fully expires in 2027; and
- A near-doubling of the section 179 expensing allowance – the most valuable tax preference for small businesses – and in the allowance's phaseout threshold, with the expansion made permanent and indexed to inflation.[7]

Certain changes enacted by TCJA also have the potential to raise tax burdens on small businesses:

- TCJA limited through 2025 (and members of both parties in Congress subsequently extended through 2028) limits on net operating losses (NOLs) taken by pass-through business owners to offset non-business income;[8]
- TCJA also limited, on a permanent basis, NOL deductions for corporate taxpayers and repealed the ability to carry back NOLs and reduce income in a prior taxable year;[9]
- TCJA switched the tax treatment of businesses' research and development (R&D) expenditures from full expensing to five-year amortization effective in 2022, raising tax burdens on small businesses making those investments; and
- TCJA proposed limits on the deductions businesses can take for interest on debt financing, effective 2022; the previous limit was based in part on 30 percent of adjusted taxable income (ATI) based on earnings before interest, taxes, depreciation, and amortization (EBITDA) while the new limit is 30 percent of ATI based on earnings before interest and taxes (EBIT).

NTU and its sister organization, NTU Foundation, have long encouraged lawmakers to correct TCJA's treatment of R&D expenditures from 2022 onwards and restore full and immediate expensing for R&D. A recent report in *The Wall Street Journal* underscores that small and start-up businesses have been adversely affected by the switch to five-year amortization for R&D expenditures, with one small business leader telling the *Journal*, "[i]t's 100% going to prohibit me from growing any more the next three years."[10] Fortunately, there is strong bipartisan support for full R&D expensing. Recent legislation introduced in the Senate (S. 866) that would restore full expensing for R&D has the support of more than one-fifth of the Senate – 11 Republicans, eight Democrats, and two independents who caucus with the Democratic Party.[11] This is a vital issue for American small businesses that Congress must act on in 2023.

---

[7] For more on section 179 and other tax provisions affecting small businesses in TCJA, see: "Guenther, Gary. "P.L. 115-97, the 2017 Tax Revision, and Small Business Taxation." Congressional Research Service, Updated February 9, 2018. Retrieved from: https://crsreports.congress.gov/product/pdf/IF/IF10723 (Accessed April 12, 2023.)

[8] For more, see: Internal Revenue Service. (2023). "Publication 536 (2022), Net Operating Losses (NOLs) for Individuals, Estates, and Trusts." Retrieved from: https://www.irs.gov/publications/p536 (Accessed April 12, 2023.)

[9] Gravelle, Jane G. "Tax Treatment of Net Operating Losses (NOLs) in the Coronavirus Aid, Relief, and Economic Security (CARES) Act." Congressional Research Service, Updated May 13, 2021. Retrieved from: https://crsreports.congress.gov/product/pdf/IN/IN11296 (Accessed April 12, 2023.)

[10] Rubin, Richard. "Small Businesses Face Big Tax Bills From Research-Deduction Change." *The Wall Street Journal*, March 17, 2023. Retrieved from: https://www.wsj.com/articles/small-businesses-face-big-tax-bills-from-research-deduction-change-a189b113?st=brca0t4uvdlvb9o&reflink=desktopwebshare_permalink (Accessed April 12, 2023.)

[11] Congress.gov. "S.866 - American Innovation and Jobs Act." Introduced March 16, 2023. Retrieved from: https://www.congress.gov/bill/118th-congress/senate-bill/866 (Accessed April 12, 2023.)

NTU also strongly believes that Congress should make full and immediate expensing for short-lived assets (i.e., 100 percent bonus depreciation) permanent, and that such a policy change would benefit small businesses as well as mid-sized and large American businesses. Data from the Joint Committee on Taxation suggests that, in 2017, businesses with less than $10 million in receipts reported $88.9 billion in bonus depreciation deductions.[12]

As we approach the 2025 expiry of reduced individual income tax returns, higher AMT thresholds, and higher estate, gift, and GST exemption amounts, lawmakers in Congress should consider how the expiry of these policies could negatively affect small businesses and small business owners by increasing their tax burdens. While heated rhetoric on TCJA has been in no short supply, we believe an honest and bipartisan assessment of the law's changes to the tax code will lead lawmakers in both parties to identify provisions that are beneficial to small businesses and should be made permanent.

Recent Proposals That Would Affect Small Businesses

President Biden's Treasury Department recently released its "General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals," colloquially referred to as the Green Book.[13] Several of the administration's proposals would increase taxes on small businesses and/or their owners. This includes, but is not limited to:

- The administration's proposal to **increase the corporate income tax rate from 21 percent to 28 percent**, which the Treasury Department estimates would increase revenues by $1.326 trillion from fiscal years (FYs) 2024-2033. While the vast majority of these revenue increases would fall on large C corporations, a portion of the revenue increases would no doubt fall on small and mid-sized C corporations as well.
- The administration's proposal to **make permanent the stricter limits on pass-through NOLs currently in effect through 2028, while tightening those limits further**, which the Treasury Department estimates would increase revenues by $71 billion from FYs 2024-2033. The administration's defense of these proposals is limited to a vague reference to "misreporting" of NOLs and the distortive effects NOL deductions may have on a business's entity organization choice. However, the allowance of NOLs for both pass-through businesses and corporations helps smooth out "lumpy" tax burdens over time, as stated by former NTU Foundation Vice President Nicole Kaeding in April 2020.[14] NOL deductions also, per the Congressional Research Service (CRS), "[help] to minimize the distorting effects taxation has on risky investment decisions. As a result, limiting the NOL offset amount may deter certain investments."[15]

---

[12] TCJA increased the bonus depreciation allowance for qualified assets from 50 percent to 100 percent for property acquired after September 27, 2017. JCT's data reviews bonus depreciation deductions for calendar year 2017, which may reflect property eligible for 50-percent bonus depreciation *and* property eligible for 100-percent bonus depreciation. For more, see: Joint Committee on Taxation. "Tax Incentives for Domestic Manufacturing." March 16, 2021. Retrieved from: https://www.jct.gov/publications/2021/jcx-15-21/ (Accessed April 12, 2023.)

[13] Department of the Treasury. "General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals." March 9, 2023. Retrieved from: https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf (Accessed April 12, 2023.)

[14] Kaeding, Nicole. "Net Operating Losses Aren't Handouts." NTU Foundation, April 14, 2020. Retrieved from: https://www.ntu.org/foundation/detail/net-operating-losses-arent-handouts

[15] Congressional Research Service. "Tax Expenditures: Compendium of Background Material on Individual Provisions." December 2022, Retrieved from: https://www.govinfo.gov/content/pkg/CPRT-117SPRT49569/pdf/CPRT-117SPRT49569.pdf (Accessed April 12, 2023.)

- The administration's proposal to **apply the net investment income tax (NIIT) to pass-through business income**, which the Treasury Department estimates would raise $306 billion from FYs 2024-2033; and the administration's proposal to **increase the NIIT and additional Medicare tax rate**, which the Treasury Department estimates would raise $344 billion from FYs 2024-2033. NTU Foundation wrote in March that, "[i]t's difficult to determine how significantly President Biden's proposals would affect investment in the U.S., but by increasing the tax rate on investment (particularly the increased NIIT rate from 3.8 percent to 5.0 percent for households with more than $400,000 in income) the Biden proposals may negatively impact investment. The expansion of the Additional Medicare Tax and NIIT bases to pass-through business income may also discourage investment by affecting how business owners and partners organize both their business structure and the income they receive from their business activity."[16]
- The administration's proposal to **increase the top marginal individual income tax rate**, which the Treasury Department estimates would raise $235 billion from FYs 2024-2033. This proposal will no doubt affect many pass-through business owners who, due to their business income, pay the top individual income tax rate. Their rate of taxation would rise 2.6 percentage points, or seven percent, from its current rate of 37 percent, and could negatively impact pass-through business growth and investment.

The Biden administration and some lawmakers have argued that these proposals can help offset new spending initiatives or expanded tax credits for low- and middle-income Americans. This may be true, but policymakers must also grapple with the effect these tax increases would have investment and job creation for small businesses, particularly pass-through business owners who would be affected by proposals to increase the top individual income tax rate, apply the NIIT to pass-through business income, and raise the NIIT tax rate.

Tax Administration and IRS Funding

The Internal Revenue Service (IRS) recently released its spend plan for the $80 billion the IRS received in last year's Inflation Reduction Act (IRA).[17] While the spend plan is short on some key details, it does make reference to initiatives and projects that could affect small business taxpayers. The IRS makes several references to Treasury Secretary Janet Yellen's pledge to not increase audit rates on small businesses making under $400,000 per year relative to historical levels. However, the IRS also pledges to step up enforcement of "large partnerships," which they appear to define as partnerships "with assets exceeding $5 million." The Committee should scrutinize this threshold, since many small business partnerships could have assets of around or even in excess of $5 million and still be considered "small" by many policymakers' standards.

Congress should also step in where the IRA declined to weigh in on the protection and enhancement of taxpayer rights. One such bill, the Small Business Taxpayer Bill of Rights from Sen. John Cornyn (R-TX) and Rep. David Kustoff (R-TN), would ensure that small businesses have access to due process and to expanded alternative dispute resolution procedures as the IRS increases enforcement activities under the IRA.[18]

---

[16] Lautz, Andrew. "What President Biden's Medicare Solvency Proposals Could Mean for Your Tax Bill." NTU Foundation, March 7, 2023. Retrieved from: https://www.ntu.org/foundation/detail/what-president-bidens-medicare-solvency-proposals-could-mean-for-your-tax-bill

[17] IRS. (April 2023)."Internal Revenue Service Inflation Reduction Act Strategic Operating Plan." Retrieved from: https://www.irs.gov/pub/irs-pdf/p3744.pdf (Accessed April 13, 2023.)

[18] Sepp, Pete; and Lautz, Andrew. "Senate Bill Would Provide Small Business Taxpayers With New Rights." NTU, May 17, 2021. Retrieved from: https://www.ntu.org/publications/detail/senate-bill-would-provide-small-business-taxpayers-with-new-rights

Again, we appreciate your attention to the important tax policy issues facing small businesses in 2023, and hope the 118th Congress acts to advance pro-growth and pro-small business policies in the years ahead.

Sincerely,

Brandon Arnold
Executive Vice President, National Taxpayers Union

CC: Members of the House Committee on Small Business