

Testimony of

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On Behalf of the

Air Conditioning Contractors of America (ACCA)



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Pro-Growth Tax Policy: Why Small Businesses Need Individual
Tax Reform

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Chairman Walsh, Ranking Member Schrader, and members of the Subcommittee on Economic Growth, Tax and Capital Access, thank you for allowing me this opportunity to provide testimony on behalf of the small business contractors of the heating, ventilation, air conditioning, and refrigeration (HVACR) industry.

My name is Gary Marowske, and I am the President of Flame Heating, Cooling, Plumbing & Electrical in Warren, Michigan. Our company offers maintenance, repair, and installation services for heating, cooling, plumbing, electrical, and indoor air quality equipment to residential and commercial clients throughout Metro Detroit. Like a lot of small businesses in the HVACR industry, ours is a family owned company, started in 1949 by my father, Robert Marowske. From a humble beginning, we have grown steadily and today employ 70 workers, own a fleet of more than 60 vehicles, and have installed more than 75,000 home comfort systems.

I come before you this afternoon as a proud member of the Air Conditioning Contractors of America (ACCA) where I serve as Chairman of the Government Relations Committee.

Every day, more than 4,000 ACCA member companies across the nation help homeowners, small business owners, and building managers realize the comfort, convenience, and cost benefits of highly efficient HVACR equipment. Nearly three fourths of ACCA's member companies have fewer than 25 employees, and 92% have fewer than 100 employees.

It's an honor to present testimony before you today and I want to commend the Committee for its leadership and its efforts to give voice to America's small businesses in the current tax reform debate. I hope that my testimony today will be helpful to this subcommittee and to the rest of Congress as we all work to improve the economic recovery.

As Congress considers an overdue and much needed reform to the tax code, the interests of the great economic engine, America's small businesses, cannot be overlooked. Small businesses like mine employ 70 percent of the workforce and are the chief source of new jobs in an economic recovery.

Tax reform must be comprehensive

I wholeheartedly agree that tax reform must address individual rates because of their impact on small businesses. Not everyone understands that sole proprietors, partners, and S Corporation shareholders pay taxes on business income through the individual income rate schedules. These are generally referred to as "pass-through" entities and they make up the bulk of the small businesses in the United States. It is estimated that more than 90% of all US businesses are pass-through entities.

Flame Furnace is organized as an S Corp, as are most of the small businesses in the specialty construction trades. Organizing as a pass-through protects the owners and shareholders from business liabilities and debts, and allows small firms to take advantage of business deductions, and facilitates the transfer of ownership through stock.

Because S corporations pay taxes on business income at the individual rates, Congress should be very careful before enacting any tax reform proposals that tinker with the individual tax rates.

In 2009, 7% of federal tax revenue came from the income taxes paid directly by C Corporations, what most people assume a corporation to be. Individual income tax revenue, *including that from all the pass-through businesses*, was 44 percent of total federal tax revenue in 2009. Unfortunately, it's nearly impossible to say exactly how much came from taxing the net income passed through. Rounding out the breakdown were payroll taxes (employer and employee) at 42 percent, excise taxes at three percent, and "other taxes" which includes estate and gift taxes, customs duties, Federal Reserve earnings/losses, and miscellaneous receipts, at four percent.

While I understand the purpose of today's hearing is to look at the impact of changes to individual rates on small businesses, I must take this opportunity to say that it is encouraging to see Congress take a comprehensive approach to tax reform by looking at the individual, corporate, and international tax codes.

America's small businesses are looking for a simple, rational, and permanent tax code that will encourage prosperity and foster job creation.

The tax code should be simple and rational

The tax code is a powerful tool that can affect individual and corporate behaviors in ways that advance beneficial public policies. Use of the tax code to create incentives for individuals and small businesses can have positive effects on the economy. For example, allowing homeowners to utilize the mortgage interest deduction makes homeownership more attractive and affordable and helps drive the construction industry.

Our industry has seen tremendous positive benefits from the residential energy tax credits found in Section 25C of the tax code. Section 25C allows eligible taxpayers who install qualified new furnaces, boilers, central air conditioners, heat pumps, hot water heaters, and other improvements in their primary residences to claim a non-refundable tax credit. All an eligible taxpayer has to do is install a qualified appliance and they can take advantage of the credit.

In 2006 and 2007, homeowners were able to claim 10% of the installed costs (up to \$500) in tax credits, depending on the type of qualified improvements they made. In 2009 and 2010, the value of the tax credit was boosted to 30% of the installed costs up to \$1,500. When the tax credits were extended for 2011, the values were reduced back to 10% of the installed costs up to \$500.

Retrofitting HVACR and hot water appliances can be an expensive investment in a home. Despite the higher first costs, ACCA members saw an increase in sales because the tax credits reduced initial investment and shortened the payback period for qualified HVACR retrofits. The policy to grant the tax credit meant homeowners paid less in their utility

bills to heat and cool their homes, experienced better indoor air quality and comfort, and the resulting reduction in energy use meant fewer greenhouse gases were released into the environment. But even more importantly, even though these tax credits are aimed at individual taxpayers, these valuable incentives helped the small businesses of the HVACR industry.

Based on our own surveys, a clear majority of ACCA's member companies saw positive benefits from these tax credits in 2009 and 2010. In a survey conducted last year, 46% of ACCA's contractor members saw a "significant" increase in the sale of qualifying HVAC equipment after the increase in the tax credit value. Another 32% saw a small increase in the sale of qualifying HVAC equipment. When taken in tandem, more than 75% of ACCA's contractor members saw an increase in the sale of qualifying higher efficiency equipment.

When the tax credit values were reduced for 2011, consumer interest waned. At the lower value level, the most a taxpayer can claim for a high efficiency furnace is \$150, not enough to justify reaching higher than the base model furnace in the short term.

The 25C tax credits do not favor the wealthy. According to IRS statistics, fully 93% of tax credit claims under 25C and 25D (for solar, geothermal, wind, and photovoltaic properties) were made by taxpayers who have an adjusted gross income of no more than \$200,000, which is indicative of a middle class tax program.

Examining the 2009 Estimated Data Line Counts for Individual Tax Returns gives a clear picture of how homeowners used \$1,500 residential energy tax credits in 2009.

Taxpayers use the Form 5695 worksheet to claim one of several available residential energy credits. The taxpayer first calculates the total cost of qualified expenditures, then reduces that amount by 30%, and compares that value with \$1,500. The taxpayer is eligible for tax credits equal to the lesser amount.

Data from the tax forms filed in 2009 tells us how many taxpayers claimed the residential energy tax credits; how many claimed a credit for the purchase of a qualified central air conditioner, heat pump, or hot water heater; a qualified furnace or hot water boiler, or an advanced main air circulating fan; and the total expenditures on these improvements.

In 2009, 6,753,885 households filed Form 5695 to claim a credit against their tax liability for installing some type of energy efficient appliance or retrofit measure in their primary home.

Of that total amount, 976,380 households claimed for purchasing and installing "energy efficient building property," otherwise known as a qualified central air conditioner, heat pump, or hot water heater totaling \$3,968,715,000 in expenditures.

In 2009, 1,290,640 taxpayers claimed tax credits for "qualified natural gas, propane, or oil furnaces or hot water boilers" and reported total expenditures of \$4,310,456,000.

And 221,274 taxpayers claimed some credit for an advanced main air circulating fan, with an aggregate expenditure amount of \$694,422,000.

For all retrofit measures and appliances that qualified for the tax credit, including energy efficient windows and door, insulation, and roofing materials, American taxpayers claimed \$5.17 billion in tax credits on \$25.1 billion worth of work. This is a significant number, especially when you consider that it only represents what was filed. What's missing is the work performed for a taxpayer who ended up not being able to use the tax credit because it turned out they weren't eligible.

The National Association of Home Builders estimates every \$100,000 in remodeling expenditures generates 1.11 full-time jobs.

The 25C tax credits highlight how a simple tax incentive can help individuals and small businesses and the create an economic benefit. Congress needs to extend the 25C tax credits beyond their expiration at the end of this year, and restore the tax credit to \$1,500.

Regrettably there are few federal incentives that make sense for commercial building or rental property owners who want to make energy efficient improvements. Every building is unique and Congress should provide ways to encourage more energy efficient improvements to the variety of commercial buildings.

As Congress considers tax reform, it should look at changes to the depreciation schedules that require most commercial HVACR equipment to be recovered over a 39 year period. When you realize that properly installed and maintained HVACR equipment has an expected lifespan of fifteen to twenty years, there is almost no incentive to replace at all.

Without any incentive to replace aging HVACR equipment, small businesses will continue to maintain and repair old, inefficient furnaces, air conditioners, chillers, and boilers. According to the Department of Energy's 2005 Buildings Energy Databook and the Energy Information Administration, commercial buildings account for 18% of total US energy consumption. Within those buildings, 14.2% of the energy consumed goes toward space heating, 13.1% goes toward space cooling, and 6% goes toward ventilation. All told, nearly \$142 billion was spent nationally in 2005 on space heating and cooling for residential and commercial buildings combined. According to the 2005 Residential Energy Consumption Survey, since 1990 only 30% of commercial buildings have had their main heating equipment replaced, and only 37% have had their main cooling equipment replaced.

A change in the tax code to bring the depreciation schedules more in line with reality would reduce energy use and help many small firms located in commercial properties like professional townhouse suites, doctor's offices, and strip malls that use smaller and less expensive commercial HVAC equipment. Changing the rules regarding depreciation would stimulate domestic job creation at the manufacturing, distribution, and contractor segments in an emerging green market economy. In the past 15 years there have been

dramatic advancements in HVACR technology, making the equipment manufactured today extremely energy efficient, which means lower utility bills and less energy use. Providing a financial incentive to building owners now would encourage them to upgrade to more energy efficient equipment instead of waiting until their outdated equipment breaks down beyond repair, which is the current practice today.

Tax reform must be long term, not piecemeal or through short term fixes

All of America's small businesses applauded the passage of H.R. 4, the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011 that repealed the Form 1099 filing provision. And we are hopeful that the Senate can pass and the President will sign H.R. 674 to repeal the 3% withholding tax on government contracts. But the effort to pass these two small business priorities highlights the piecemeal and short term approach Congress has taken with regard to the tax code.

Last year, Congress passed The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 that extended more than 60 tax provisions benefited individuals and small businesses just two weeks before they were set to expire. Included in the bill were a temporary extension of the Bush Tax Cuts, a short term estate tax reduction, a short term extension of bonus depreciation and modification to Section 179 expensing rules, a one year extension of the Alternative Minimum Tax "patch", and a temporary extension of the residential energy tax credits described above.

While the extension of these tax incentives is greatly appreciated, the timing and nature of their extension make it very difficult for businesses to make business decisions.

America's small business owners are crippled by fear - fear of the unknown of what may or may not happen next year. By sending the right signals to America's small businesses, Congress can eliminate the fear of the unknown in the future. We all need clear communication of what is coming next and what needs to be done and I assure you American small businesses will rise up and create new jobs.

With that I will conclude my comments and would be happy to answer any questions you may have. Thank you again for this opportunity to testify before you today.