

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

Memorandum

To: Members, Subcommittee on Economic Growth, Tax, and Capital Access
From: Committee Staff
Date: November 30, 2015
Re: Hearing: "Employers of Choice: How the Tax Extender Debate Will Affect Small Business"

On December 3, 2015 at 10:00 am, the Subcommittee on Economic Growth, Tax and Capital Access will meet in Room 2360 of the Rayburn House Office Building for the purpose of receiving testimony on why small firms are seen as employers of choice. The hearing also will address certain tax policies that affect the ability of small firms to attract and retain employees.

Small Business Characteristics and Public Perceptions

Small businesses, those with fewer than 500 employees,¹ are generally the creators of the most new jobs, as well as the employers of about half of the nation's private sector workforce. Small firms accounted for 63 percent of the net new jobs created between 1993 and mid-2013 (or 14.3 million of the 22.9 million net new jobs).² Small businesses also account for about 46 percent of the nonfarm, private real gross domestic product.³ Starting in late 2009 and early 2010, small firms appear to have suffered more from deteriorating business conditions than large businesses. Profits at larger corporate entities recovered more quickly than non-corporate profits in 2010.⁴ Since a larger share of corporations are large businesses, that likely resulted in a further weakening of the small business share of GDP.⁵

Traditionally, Americans have held small businesses in high esteem. Americans are more than three times as likely to express confidence in small business as they are in big

¹ There are multiple definitions of small business and this memorandum adopts one such categorization, less than 500 employees.

² UNITED STATES SMALL BUSINESS ADMINISTRATION, OFFICE OF ADVOCACY, FREQUENTLY ASKED QUESTIONS 1 (2014), available at https://www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf.

³ KATHRYN KOBE, SMALL BUSINESS GDP: UPDATE 2002-2010, at 1 (SBA contract no. HQ-10-M-0258) (2012), available at https://www.sba.gov/sites/default/files/rs390tot_1.pdf.

⁴ *Id.*

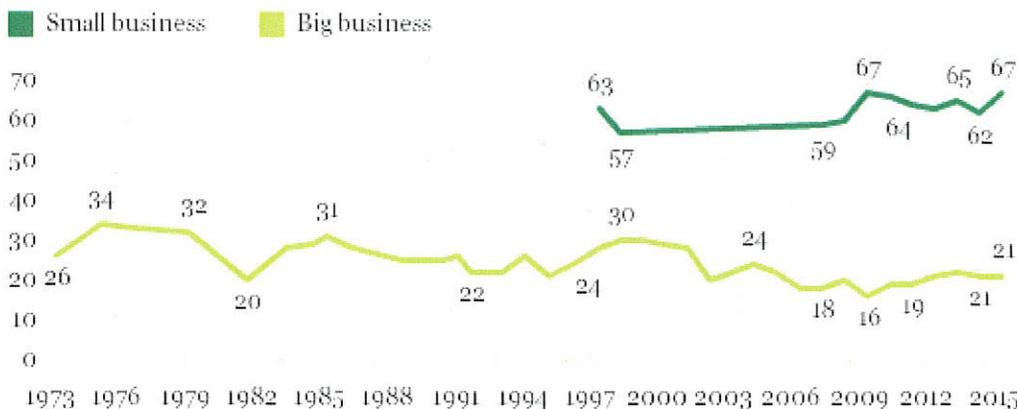
⁵ *Id.*

business.⁶ Sixty-seven percent of Americans in 2015 report having “a great deal” or “quite a lot” of confidence in small business, eclipsing the 21 percent who are similarly confident in big business. Confidence in small business is up slightly from last year’s 62 percent, while confidence in big business is unchanged.⁷

Americans' Confidence in Small Business vs. Confidence in Big Business

Now I am going to read you a list of institutions in American society. Please tell me how much confidence you, yourself, have in each one -- a great deal, quite a lot, some or very little?

% A great deal or quite a lot



GALLUP

Since small firms are more likely to be run or owned by residents of the communities they serve, small businesses are often seen as more responsive to the needs of local communities than are large corporations that must heed the decisions of distant managers and shareholders.⁸ American confidence in small businesses to serve local needs and generate economic growth does not result in small firms easily hiring the employees they need; in fact, small businesses must compete in a fluid labor market in which qualified potential employees can market their skills to both large and small firms.

Employees at Small Firms

To find success in today’s knowledge-based global economy, companies know that creative, adaptable and engaged employees are a critical asset – not just to compete in the current market – but also to create the products and services that will ensure the company’s future.⁹ To win this war for talent, firms know that they must become “employers of choice”

⁶ http://www.gallup.com/poll/183989/americans-confident-small-big-business.aspx?g_source=small%20business&g_medium=search&g_campaign=tiles.

⁷ *Id.*

⁸ *Id.*

⁹ HARVARD BUSINESS REVIEW ANALYTIC SERVICES, THE EMPLOYER OF CHOICE 1(2013), available at https://hbr.org/resources/pdfs/comm/siemens/hbr_siemens_report.pdf.

so that their organizations can bring together the best individuals to work on the challenges and opportunities of a new economy.¹⁰ Employers of choice are those that who offer a work culture and workplace environment that attract and retain superior employees. The features of the environment available at an employer of choice favor the well-being of employees and customers.¹¹

Increasingly, smaller firms have expanded the traditional benefits they offer prospective employees in the face of greater competition for talent. Small firms are offering more non-traditional benefits, such as greater work/home balance packages with flex time,¹² wellness programs and incentives,¹³ and bonuses with stock options and profit-sharing arrangements.¹⁴

Small firms constantly look for ways to adapt to the changing employment landscape. However, their ability to compete for talented employees is often hindered by Federal regulatory¹⁵ or statutory¹⁶ action (or in some cases – inaction).¹⁷ One area of particular importance is tax policy and the tax treatment of various small business activities that would enable such firms to devote more resources to competing against larger firms for talented employees.

Tax Policy Implications for Small Business and the Tax Extenders

According to the Internal Revenue Service's (IRS) National Taxpayer Advocate, tax issues are a significant set of regulatory burdens for most small businesses.¹⁸ Small businesses are affected disproportionately by tax complexity – a finding that has not changed with time.

¹⁰ *Id.*

¹¹ <http://humanresources.about.com/od/glossarye/g/employer-of-choice.htm>

¹² *The Consequences of DOL's One-Size-Fits-All Overtime Rule for Small Businesses and their Employees: Hearing before the Subcomm. on Investigations, Oversight and Regulations of the H. Comm. on Small Business, 114th Cong. (October 8, 2015) (testimony of Terry Shea), available at http://smbiz.house.gov/uploadedfiles/10-8-15_shea_testimony.pdf.*

¹³ *Self-Insurance and Health Benefits: An Affordable Option for Small Business?: Hearing before the Subcomm. on Health and Technology of the H. Comm. on Small Business, 113th Cong. (November 14, 2013) (testimony of Michael Ferguson), available at http://smallbusiness.house.gov/uploadedfiles/11-14-2013_ferguson_testimony.pdf*

¹⁴ <http://blogs.wsj.com/experts/2014/02/06/small-businesses-start-giving-employee-stock-options/>.

¹⁵ *See, e.g., Tangled in Red Tape: New Challenges for Small Manufacturers: Hearing before the H. Comm. on Small Business, 114th Cong. (2015), available at <http://smallbusiness.house.gov/calendar/eventsingle.aspx?EventID=397862>; Will EPA's 'Waters of the United State's Rule Drown Small Businesses: Hearing before the H. Comm. on Small Business, 113th Cong. (2014), available at <http://www.gpo.gov/fdsys/pkg/CHRG-113hhr88042/pdf/CHRG-113hhr88042.pdf>.*

¹⁶ *See, e.g., The Health Care Law: Implementation and Small Businesses: Hearing before the H. Comm. on Small Business, 113th Cong. (2013), available at <http://www.gpo.gov/fdsys/pkg/CHRG-113hhr80820/pdf/CHRG-113hhr80820.pdf>; Financing Main Street: How Dodd-Frank is Crippling Small Lenders and Access to Capital: Hearing before the Subcomm. on Economic Growth, Tax and Capital Access of the H. Comm. on Small Business, 114th Cong. (2015), available at <http://smallbusiness.house.gov/calendar/eventsingle.aspx?EventID=398424>.*

¹⁷ <http://www.forbes.com/sites/chancebarnett/2015/10/27/sec-to-vote-on-title-iii-equity-crowdfunding-rulings-october-30th/>.

¹⁸ *Reforming the Tax Code to Assist Small Business: Hearing before the H. Comm. on Small Business, 109th Cong. (2005) (testimony of Nina E. Olson), available at <http://www.gpo.gov/fdsys/pkg/CHRG-109hhr24846/pdf/CHRG-109hhr24846.pdf>.*

In 2005, a study sponsored by the Office of the Chief Counsel for Advocacy at the Small Business Administration found that firms with less than 20 employees paid \$1,304 per employee for tax compliance.¹⁹ An update to that study in 2010, found that small firms pay 67% more to comply with the tax code than large firms do, with tax complexity a contributing factor.²⁰ The most recent update of the studies on the regulatory impact on small businesses found that firms with less than 50 employees pay, on average, \$1,518 per employee in tax compliance costs, whereas firms with more than 100 pay \$647.²¹

Most small businesses find it difficult to stay current on tax laws because so many tax provisions are temporary.²² Effective only for a few years or even months and regularly prolonged, these provisions (commonly referred to as tax “extenders”) leave small business owners guessing at their tax liabilities. This uncertainty hinders the ability of small firms to compete with larger firms that have a better grasp of their tax liability in any given year.

At the end of 2013, over 50 temporary tax provisions²³ expired. Many of these extenders are commonly utilized by small businesses, including the research and experimentation tax credit, provisions allowing shorter depreciation of business equipment and incentives for the use of alternative energy.²⁴ The temporary nature stems, in part, from congressional difficulty in finding revenue offsets. As a result, some believe that these provisions should be addressed as part of comprehensive tax reform.²⁵ Many of these provisions were retroactively extended through Fiscal Year 2014 when the Tax Increase Prevention Act of 2014²⁶ (TIPA) was signed into law on December 19, 2014. These temporary renewals are part and parcel of the constant change in the tax code – a persistent feature²⁷ that is especially unmanageable for small businesses trying to utilize these provisions.

While small firms certainly would benefit from the certainty of tax permanency for various provisions denominated as tax extenders, temporary tax extensions will be accepted by

¹⁹ W. MARK CRAIN, THE IMPACT OF REGULATORY COSTS ON SMALL FIRMS 5 (2005), *available at* <https://www.sba.gov/sites/default/files/files/rs264tot.pdf>.

²⁰ NICOLE V. CRAIN & W. MARK CRAIN, THE IMPACT OF REGULATORY COSTS ON SMALL FIRMS 7-8 (2010), *available at* <https://www.sba.gov/sites/default/files/The%20Impact%20of%20Regulatory%20Costs%20on%20Small%20Firms%20%28Full%29.pdf>.

²¹ W. MARK CRAIN & NICOLE V. CRAIN, THE COST OF FEDERAL REGULATION TO THE U.S. ECONOMY, MANUFACTURING, AND SMALL BUSINESS 2 (2014), *available at* <http://www.nam.org/Data-and-Reports/Cost-of-Federal-Regulations/Federal-Regulation-Full-Study.pdf>.

²² Large firms with tax attorneys and accountants on staff (and often corporate lobbying offices in Washington, DC) are able to stay current on the shifting tax landscape.

²³ JOINT COMMITTEE ON TAXATION, LIST OF EXPIRING FEDERAL TAX PROVISIONS 2014-2025 (January 9, 2015), *available at* www.jct.gov.

²⁴ <http://www.forbes.com/sites/ashleaebeling/2014/12/19/obama-signs-2014-tax-extenders-money-in-your-pocket/>.

²⁵ *See, e.g.* NFIB, SMALL BUSINESS GROWTH AGENDA FOR THE 114th CONGRESS 4 (2014), *available at* <http://www.nfib.com/Portals/0/PDF/AllUsers/IssuesElections/nfib-growth-agenda-congress.pdf>; NATIONAL SMALL BUSINESS ASSOCIATION, LAME DUCK SESSION PRIORITIES 4 (2014), *available at* <http://www.nsba.biz/wp-content/uploads/2014/11/Lame-Duck-Survey-2014.pdf>.

²⁶ Pub. L. No. 113-295, 128 Stat. 4010 (2014).

²⁷ <http://taxfoundation.org/blog/another-year-another-tax-extenders-bill>.

small firms.²⁸ In an economy where operating capital is scarce, a robust extenders package offers small firms the opportunity to maximize their deductions and credits that enable them to remain competitive in the marketplace for employees.²⁹ That conclusion was confirmed by a National Small Business Association survey in October of 2014, which found that 76 percent of respondents stated that enactment of a robust tax extender package was either “very important” or “important.”³⁰

Chairman Brady of the Committee on Ways and Means has announced that the Committee will work to put together a package of a package of permanent provisions among those expired tax breaks before the end of the year.³¹ Additionally, the Senate Finance Committee passed legislation³² that would retroactively extend expired tax provisions, for two years, through 2016. No further action has been taken on this legislation by the Senate. So work has begun on extending these beneficial tax provisions, but small firms again lament the timing.³³

Selected Tax Provisions Utilized by Small Businesses that Expired on Dec. 31, 2014³⁴

Similar to the end of 2014, when Congress passed the Tax Increase Prevention Act of 2014, small firms are again looking to Congress to pass legislation by the end of December to ensure several popular tax provisions are available for tax year 2015 because the TIPA only renewed them until December 31, 2014.

Bonus Depreciation

Bonus depreciation has allowed firms to deduct part of the cost of equipment (most recently 50%) in the year it was placed into service, rather than recover the cost over a period of time. It was authorized on two occasions; in 2002 in the Job Creation and Worker Assistance Act of 2002³⁵ and in 2008 in the Economic Stimulus Act of 2008.³⁶ The 2002 stimulus was allowed to expire as planned in 2004, and the bonus depreciation introduced in 2008 was in place for seven years (2008-2014), although its size varied over that period.

²⁸ <http://investinamericasfuture.org/PDFs/2011%20Broad%20Tax%20Extenders%20Letter.pdf>.

²⁹ <http://thehill.com/blogs/congress-blog/economy-budget/225212-small-businesses-need-tax-extendors-now>.

³⁰ NATIONAL SMALL BUSINESS ASSOCIATION, LAME DUCK SESSION PRIORITIES 4 (2014), available at <http://www.nsba.biz/wp-content/uploads/2014/11/Lame-Duck-Survey-2014.pdf>.

³¹ <http://blogs.wsj.com/washwire/2015/11/06/qa-house-ways-and-means-chairman-kevin-bradys-tax-plans/>.

³² S. 1946, the Tax Relief Extension Act of 2015.

³³ <http://www.forbes.com/sites/jimblasingame/2015/10/23/washingtons-new-hashtag-withoutanysenseofshame/>.

³⁴ While some small businesses may take advantage of additional provisions, the ones outlined in this section are the ones that the Committee has heard from small firms in various meetings, testimonies and correspondence to be the most important.

³⁵ Pub. L. No. 107-147, §101, 116 Stat. 21, 22 (2002).

³⁶ Pub. L. No. 110-185, §103, 122 Stat. 613, 618 (2008).

Section 179 Expensing

This provision allows firms to expense, or deduct immediately with specific dollar limits, the cost of investment in equipment.³⁷ In 2014, this amount was \$500,000. Once a firm's investment reached at least \$2 million, the amount eligible is reduced one dollar for each dollar of investment in excess of \$2 million. Thus, once a firm's investment reaches \$2.5 million, no deduction is allowed, and the investment is amortized over time.

The first expensing provision was relatively small when adopted as a permanent provision in the Small Business Tax Revision of 1958.³⁸ It allowed a deduction of 20 percent of the first \$20,000 and was justified as simplification of depreciation rules for small firms as an incentive to invest in capital equipment. The limits were revised over time and the changes were made permanent. Temporary increases came much later, most recently as part of the Small Business Jobs Act of 2010,³⁹ which raised the expensing amount to its current level of \$500,000 until it expired at the end of 2014.

Tax Credit for Research and Experimentation (R&E) Expenses

The R&E tax credit was designed to encourage technology-based companies to invest in additional resources in the research, development, and testing of various products and services. Such investment can lead to job creation and economic expansion. Small firms (particularly start-ups with limited initial income) can utilize the R&E tax credit to get new ideas off of the ground in the absence of outside investment or access to enough working capital to initiate such research.

The R&E tax credit has never been a permanent provision of the federal tax code. Since its enactment in the Economic Recovery Tax Act of 1981,⁴⁰ it has been extended numerous times, lapsed for one year and has been extended retroactively. The most recent extension provided a tax credit for up to 20 percent of qualified research costs over a base amount (or a 14 percent Alternative Simplified Credit); 20 percent of basic research payments; and 20 percent for energy research.⁴¹ If a taxpayer elected to use the R&E tax credit, their deduction for research expenses was reduced by the amount of the R&E credit.⁴²

³⁷ Absent this treatment, the cost of the equipment must be amortized over time, thereby reducing in any given year the cost of such equipment that is deductible. W.H. HOFFMAN, ET.AL. CORPORATIONS, PARTNERSHIPS & TRUSTS 5-4-5-5 (2015 ed.).

³⁸ Pub. L. No. 85-866, §179, 72 Stat. 1606, 1679 (1958).

³⁹ Pub. L. No. 111-240, §2021, 124 Stat. 2504, 2556 (2010).

⁴⁰ Pub. L. No. 97-34, §221, 95 Stat. 172, 241 (1981).

⁴¹ *Framework for Evaluating Certain Expiring Tax Provision: Hearing before the H. Comm. on Ways and Means, 113th Cong.* (April 8, 2014) (testimony of Judith Zelisko), available at http://waysandmeans.house.gov/event/BAK_camp-announces-tax-reform-hearing-on-the-benefits-of-permanent-tax-policy-for-americas-job-creators-2/. http://waysandmeans.house.gov/event/BAK_camp-announces-tax-reform-hearing-on-the-benefits-of-permanent-tax-policy-for-americas-job-creators-2/.

⁴² *Id.*

Conclusion

Small firms are often at the forefront of innovation, not only in their chosen fields, but also on the human resources side. In order to compete with their larger counterparts, they often have to innovate and design benefit packages that can attract and retain top talent. Increasingly, small firms are being put in a bind by actions (or in some cases, lack of action) by the federal government. This hearing represents an opportunity for members to learn more about tax policy decisions in Washington affect the day-to-day operations of small firms across the nation.