

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

To: Members, Committee on Small Business
From: Committee Staff
Date: July 23, 2018
Re: Hearing: “The Tax Law’s Impact on Main Street”

On Wednesday, July 25, 2018 at 11:00 a.m., the Committee on Small Business will meet in Room 2360 of the Rayburn House Office Building for the purpose of examining how the recently enacted tax package has affected small businesses. The hearing will allow Members of the Committee the opportunity to hear directly from small business owners regarding the impact the law has had on their operations and their company’s outlook moving forward.

I. Introduction

On October 22, 1986, President Ronald Reagan signed the Tax Reform Act¹ into law. This framework largely outlined the tax rules for individuals and businesses for the next three decades. For a small business that was organized as a sole proprietorship,² partnership,³ or an S corporation,⁴ taxation would “pass-through” to individual income taxes. This category of small businesses are also known as pass-through entities. As tax reform conversations developed over the years, a discussion concentrated on the equitable treatment of small businesses as compared to larger businesses, which often administer their taxes through the corporate income tax. Therefore, a comprehensive overhaul of the United States Code would require a serious look at both the individual and corporate rates.

II. Tax Cuts and Jobs Act

After more than thirty years, on December 22, 2017, President Donald Trump signed into law the Tax Cuts and Jobs Act (TCJA).⁵ By concentrating on both the individual and business sides of the tax code, the TCJA ushered in monumental rate reductions for hardworking Americans across the country. Beyond lowering rates, this tax reform package also addressed numerous deductions and loopholes in the law.

¹ Pub. L. No. 99-514 (1986), 100 STAT. 2085.

² <https://www.irs.gov/businesses/small-businesses-self-employed/sole-proprietorships>.

³ <https://www.irs.gov/businesses/small-businesses-self-employed/partnerships>.

⁴ <https://www.irs.gov/businesses/small-businesses-self-employed/s-corporations>.

⁵ Pub. L. No. 115-97 (2017), 131 STAT. 2054.

A. Individuals

From an individual perspective, the TCJA enacted a number of amendments to the United States Code. It preserved the seven bracket system, but adjusted the rates and the parameters of the brackets.⁶ As an example, the highest rate was reduced from 39.6 percent to 37 percent.⁷ Additionally, individuals that decide not to itemize or list deductions when filing taxes have the opportunity to select a standard deduction. Importantly, TCJA took the existing standard deduction for individual filers that was approximately \$6,000 and doubled it to \$12,000.⁸ For married individuals filing a joint return, the amount was raised approximately from \$12,000 to \$24,000. Beyond these two items, the changes in the TCJA took great steps to assist individual tax filers.

B. Businesses

The TCJA also made a number of changes for businesses, both large and small. For large businesses that traditionally file taxes as corporations, the corporate tax rate before TCJA was 35 percent. After numerous rounds of negotiations, the final text of TCJA that was signed into law had a maximum corporate tax rate of 21 percent.⁹

For a small business or a business that is organized as a pass-through entity, TCJA contained numerous benefits. Not only were the seven individual income brackets revised downward,¹⁰ but the TCJA also included a 20 percent deduction¹¹ for certain small businesses off of their top tax rate. Special rules were set up within this provision to protect the deduction from high income individual earner abuse. For example, certain service oriented businesses are prohibited from utilizing the 20 percent deduction. However, regardless of industry, a pass-through income of \$157,000¹² on an individual return, or approximately double the amount¹³ for a joint filer, will receive the 20 percent deduction. For filers above this threshold, a wage and/or capital¹⁴ test is required to ensure appropriate small businesses have the opportunity to qualify for this 20 percent deduction.

Although the 20 percent deduction for certain small businesses in TCJA is one of the largest benefits for small businesses, the tax reform package included a number of expensing provisions to further assist small businesses. For example, the Section 179 immediate business equipment expensing threshold was doubled from approximately \$500,000 to \$1,000,000.¹⁵ When it comes to bonus depreciation, or the amount that a business can immediately deduct, TCJA increased the percentage from 50 percent to 100 percent for a temporary basis.¹⁶

⁶ I.R.C. § 1.

⁷ *Id.*

⁸ *Id.* at § 63.

⁹ *Id.* at § 11.

¹⁰ *Supra* note 6.

¹¹ *Id.* at § 199A.

¹² *Id.* at (e)(2)(a).

¹³ *Id.*

¹⁴ *Id.* at (b)(2).

¹⁵ *Id.* at § 179.

¹⁶ *Id.* at § 168.

Additionally, TCJA also amended the threshold amount on the estate tax, also known as a death tax, because it is assessed on the transfer of an estate as a result of a death.¹⁷ The threshold was revised upwards from approximately \$5 million to approximately \$10million.¹⁸ This change will assist small businesses and farmers that are already taxed throughout their operational lifetime.

III. Tax Reform Impact

A. Economic

While the overall economy is still digesting the effects of tax reform, which will continue for years to come, a few economic indicators showcase an encouraging response. Recent Gross Domestic Product (GDP) findings¹⁹ and its growth rate²⁰ have continued to record positive marks. The unemployment rate²¹ has sustained a downward trend and a recent measure of how many Americans are requesting new unemployment benefits shows a drastic decrease.²² Additionally, equipment purchases by businesses has also increased recently.²³ Further, while testifying before the House Financial Services Committee on the state of the economy, the Chairman of the Federal Reserve, Jerome Powell, commented that the healthy job market and inflation rate is a result of a few factors, including "...federal tax and spending policies."²⁴ Although the full processing of comprehensive tax reform will continue, the recent positive economic indicators and comments made by the Chairman of the Federal Reserve are promising.

B. Small Business Impact

With over 30 million²⁵ small businesses in the country, small firms have an outsized role in the economy. They are responsible for employing nearly 50 percent²⁶ of all workers. Additionally, estimates from 2008 show that small businesses contributed 46 percent of the private nonfarm GDP²⁷ for the entire nation. How small businesses digest tax reform will impact the nation's economy.

While small businesses are often not afforded the opportunity to make headline breaking news, a temperature of the small business ecosystem can be received through the numerous optimism scores or indices that survey small business owners. According to the MetLife and U.S. Chamber of Commerce Q2 Small Business Index, small businesses optimism increased for

¹⁷ <https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax>.

¹⁸ *Id.* at § 2010.

¹⁹ <https://fred.stlouisfed.org/series/GDP>.

²⁰ <https://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm>.

²¹ <https://data.bls.gov/timeseries/LNS14000000>.

²² <https://www.dol.gov/ui/data.pdf>.

²³ <https://www.newyorkfed.org/research/snapshot>.

²⁴ *Monetary Policy and the State of the Economy*, 115th Cong. (2018) (witness testimony of Hon. Jerome Powell, Chairman, Board of Governors of the Federal Reserve System).

²⁵ SBA OFFICE OF ADVOCACY, SMALL BUSINESS PROFILE (2018), available at <https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-All.pdf>.

²⁶ *Id.*

²⁷ KATHRYN KOBE, ECONOMIC CONSULTING SERVICES, SMALL BUSINESS ADMINISTRATION, SMALL BUSINESS GDP: UPDATE 2002-2010 (2012) at 4.

the fifth straight report.²⁸ Additionally, within the same survey, small business owners reported that they continue to forecast a growth in earnings as the year progresses.²⁹ Further, nearly 33 percent of all small businesses expect to be hiring additional employees.³⁰ When it comes to the health of their businesses, two thirds of all manufacturing companies are reporting increased confidence.³¹

The National Federation of Independent Business (NFIB) has been surveying small businesses since 1973.³² In their most recent published report for June 2018, the index recorded its sixth highest measure in history.³³ When asked about the single most important problem facing their businesses, the issue of taxes continues to be significantly lower than compared to a year ago.³⁴ Within a separate NFIB publication on reactions to TCJA, survey data shows that over 85 percent of small business owners believe the TCJA will produce positive results.³⁵ Additionally, more than 75 percent believe that the business environment continues to move in a positive direction.³⁶

IV. Conclusion

From sandwich shops in Ohio to startups in Kansas, small businesses are busy transforming communities and neighborhoods. With historic tax cuts passed into law, small business can utilize benefits that will not only deliver more equitable treatment when compared with big businesses, but also the opportunity to take advantage of incentives to drive their business operations forward. Despite only being a half a dozen months out from the enactment of TCJA, early signs are pointing to a healthy and robust small business response. This is instrumental, because of the impact that small businesses have on the entire national economy. When small businesses are expanding, so does the United States economy. This hearing will further advance the information Congress receives from small businesses on the ground that are living and planning within the new tax code.

²⁸ MetLife & U.S. Chamber of Commerce SMALL BUSINESS INDEX (2018) at 2.

²⁹ *Id.* at 10.

³⁰ *Id.*

³¹ *Id.* at 13.

³² National Federation of Independent Business JUNE 2018 REPORT: SMALL BUSINESS OPTIMISM INDEX (2018).

³³ *Id.* at 1.

³⁴ *Id.* at 18.

³⁵ National Federation of Independent Business SMALL BUSINESS INTRODUCTION TO THE TAX CUTS AND JOBS ACT: PART 1 (2018) at 5.

³⁶ *Id.*