

**U.S. House of Representatives**

**Committee on Small Business**

**Is the Tax Cut and Jobs Act a Help or a Hinderance to Main Street?**

**Testimony of Grafton H. Willey, IV CPA**

**July 24, 2019**

*Testimony of Grafton "Cap" Willey  
On Behalf of the National Small Business Association*

**U.S. House of Representatives**

**Committee on Small Business**

**Is the Tax Cut and Jobs Act a Help or a Hinderance to Main Street?**

**Testimony of Grafton H. Willey, IV CPA**

**July 24, 2019**

Good Morning, Chairwoman Velazquez, ranking member Chabot and members of the House Small Business Committee. My name is Grafton H. Willey, IV. Most people know me as Cap Willey. I am a CPA who has just retired from the national CPA Firm of MHM CBIZ after 47 years of dealing with small business taxation issues. I still maintain a small practice as well as consulting with Southern New England small businesses. I have been a Small Business advocate for most of my career. I served as the RI Chair of the 1986 and 1995 White House Conferences on Small Business. I am a past Chair of the National Small Business Association (NSBA). NSBA is the nation's oldest small business advocacy organization, with over 65,000 members representing every sector and industry of the United States. The NSBA is a staunchly nonpartisan organization devoted solely to representing the interests of the small businesses which provide almost half of the private sector jobs to the economy.

I am also an owner of an Italian Restaurant in RI and some businesses in the cranberry industry. I am here representing myself as a tax practitioner, myself as a small business owner, the NSBA, and the RISCPA.

In responding to questions about taxation there is always one standard answer which is "It Depends". That is applicable to the Tax Cut and Jobs Act (TCJA). There are some good things in the legislation, there are some bad things in the legislation. I view it as a work in progress. In fact according to a forthcoming NSBA Economic Survey, 29 percent of small business owners said that filing taxes in 2018 was more difficult when compared with 2017. I can tell you that tax preparers say the same thing.

In my estimation the primary need in Tax Reform was to address the competitiveness that the US was experiencing in international taxation for C-Corporation taxation. With probably the world's highest corporate tax rate of 35 percent (even though that rate was often reduced by special deductions and tax credits) we were getting killed when competing with countries like Ireland at 12.5 percent and much of Europe in the mid-20 percent's. Global corporate finance

*Testimony of Grafton "Cap" Willey  
On Behalf of the National Small Business Association*

will find ways to minimize the international tax burdens and the movement of capital is very fluid in international finance. I believe that most in Congress recognized that this was become a major problem. Bringing the corporate tax rates down to 21 percent has kept us competitive internationally where there would be less of an incentive to do major restructuring to save marginal differenced in tax rates .

The National Small Business Association (NSBA) established its basic principles of Tax Reform a few years ago. I was a major contributor to these principles. These are the principles that we measure any Tax Reform against. They are as follows:

- 1) Our system should be designed to tax only once
- 2) Our system should be stable and predictable
- 3) Our system should be visible to the taxpayer
- 4) Our system should be simple in its administration and compliance
- 5) Our system should promote economic growth and fairness between large corporations and small corporations
- 6) Our system should use commonly understood finance and accounting concepts
- 7) Our system should be grounded in reality-based revenue estimates
- 8) Our system should be fair in its treatment of all citizens
- 9) Our system should be transparent.

The Tax Cut and Jobs Act only partially measures up to these principles. We have concerns that more should be done to ensure simplification, fairness and long-term sustainability. According to the forthcoming report, when asked how to fix the Tax Cuts and Jobs Act, parity, simplification and permanency are the top priorities for small business owners.

After much discussion and analysis, the NSBA did support passage of the Tax Cut and Jobs Act. However we recognize that it is not perfect. It may be a good start at Tax Reform, but more hard work is needed in the areas of tax simplification, parity in taxation between large corporations and small businesses, doing away with sunsets, making tax reform permanent, and addressing the deficit. The NSBA has done a Tax Reform Report Card that looks at many of the various aspects of the Bill and rates the areas or concerns on a five-start rating system. I have included this Report Card in your package.

While the Tax Cut and Jobs Act encompasses a lot of areas of taxation, I will focus on how it has impacted Small Businesses as they deal with the changes in tax laws.

*Testimony of Grafton "Cap" Willey  
On Behalf of the National Small Business Association*

**Tax Simplification:**

If Tax simplification was a goal of Tax Reform this legislation was a dismal failure from a Small Business perspective. While some individual taxpayers will find filing their 1040's will be simpler with the elimination of deductions, exemptions and credits. The summary pages of the 1040 look simpler but with all of the required sub schedules it is not much different in putting together than the old forms prior to the TCJA. This legislation is not simpler for most Small Businesses. It has also not been simpler for the tax professionals preparing the tax returns. When I first read the Tax Reform legislation, I took the 400 plus pages of paper in my hand and told the staff that they should not worry about their jobs. This is not simplification.

In a recent 2017 NSBA survey 40% of Small Business owners spend 80 hours per year dealing with Federal income taxes and the majority spent more than 40 hours per year It is more than likely that most small businesses will have to rely on their tax professionals more under tax reform rather than less.

**Tax Permanency or Rate Reductions and Credits:**

As stated above the move to make the corporate rate change was important to make the US more competitive in the global economy. Making these rate change permanents is important to give the international community confidence that we are committed to maintaining a stable tax system. Unfortunately, the non-corporate and individual changes are not made permanent and are set to expire generally after 2025. My initial reaction to this was not that much concern. No way would a future Congress allow the changes to really expire. That concern has changed with me. I now see the real possibility and probability of Congress not agreeing on an extension in 2025 which would result in a substantial tax increase without a vote being taken. I can envision a lot of figure pointing by both sides blaming the other for inaction, with the taxpayers being slammed. We have seen this happen in the past and I really think that this is going to be a reality for us in 2025. For those respondents to the NSBA soon to be released Economic Survey, the biggest burden facing small business owners under the Tax Cut and Jobs Act is uncertainty with taxes moving forward. The lack of permanence is making long-term planning nearly impossible.

**Parity Between Large Corporations and Small Corporations:**

The Tax Cut and Jobs Act generally provided good benefits for Large Corporations and left Small Business short on the parity issue. I would say that the international taxation provisions of the bill are very complex and cumbersome. The tax permanency described above is a major

*Testimony of Grafton "Cap" Willey  
On Behalf of the National Small Business Association*

problem for Small Business. Most Small Businesses operate as pass-through entities for tax purposes. A recent estimate was that only 17 percent of Small Businesses operate as C-Corporations and would be able to take advantage of the lower corporate tax rates that moved from 35 percent to 21 percent.

Pass-through entities pass their income down to the shareholder/owners of the business and pay their taxes at the individual tax rates. A compromise was made to allow qualified small business pass-throughs a 20 percent (Sec 199A) deduction to attempt to provide some relief to small businesses. Unfortunately, this calculation is very complex, and the 20 percent rate does not provide equal parity with large businesses. A rate closer to 28% would have been more appropriate to provide real parity. There is a lot of questions about what constitutes a qualified small business eligible for the 20 percent deduction. I understand the reasoning behind the exclusion of personal service businesses which could have manipulated wage income and business income to their advantages. I am not sure why some specific groups were included or excluded, other than for political pressure.

Other parity issues remain such as the full deductibility of health insurance premiums and other fringe benefits favor large corporations over small businesses.

#### **Limitations on State and Local Taxes to \$10,000:**

One of the main reasons I wanted to testify before you today is to bring to your attention the problem with the limitations on State and Local taxes to \$10,000. There has been a lot of angst from the high tax states about the limitations on State and Local taxes. For example, Rhode Island is a high tax state and we are being affected by this limitation. I do not have as much of a problem with the limitation on state income taxes on wages and on real estate as some of my professional colleagues. In most other country tax systems, there are not the itemized deductions that we have had in the US. Many offer a standard deduction only.

Where I do have an issue is the taxation of state income taxes on the business income of pass-through entities. In a C-Corporation (regular Corporation) the entity pays the state and local taxes and claims a deduction for the payment before the calculation of Federal income taxes. If the entity is a small business pass-through entity the taxes are paid by the owners/shareholders. When they pay a state income tax at the individual level, they will be limited to the \$10,000 limitation which will include all of their other state and local taxes. This will mean that in most cases they will not get a tax benefit of paying the state taxes on the business income. This arrangement puts the small business pass-through at a tax disadvantage compared to the C-Corporation. The TCJA does allow for the deduction of State and Local taxes paid by the business entity. The question is if the state income tax on the business income of a

*Testimony of Grafton "Cap" Willey  
On Behalf of the National Small Business Association*

pass-through entity is paid at the entity level would it be deductible by the entity? We believe that a case can be made for that and we believe that Congress should clarify this as being allowed.

In RI, I authored a Bill that passed last month to allow a pass-through entity to elect to pay its State income tax on its business income at the entity level which hopefully will allow it a deduction for Federal income tax purposes. This set up would provide the same tax treatment that is allowed for C-Corporations. Some other states such as Connecticut, Wisconsin, and Oklahoma have enacted similar provisions.

The State and Local Tax (SALT) limitation has cause legislators in high tax states to try to set up work arounds to this limitation. The Internal Revenue Service (IRS) has attacked the attempts of some states to create deductible Charitable funds to reclassify real estate taxes paid into charitable deductions which in most cases is a sham. I concur with the IRS attack on these attempts. The IRS has published regulations stating that this arrangement will not be accepted.

The proposal on state income taxes on pass-through business income should be upheld. It should be a matter of fairness and parity. This is an area that should be solved at the Federal level rather than at the state level. This change should have bi-partisan support that would help 80 percent of Small Businesses. I have provided a copy of the RI legislation in your package as well as my testimony before the RI House Finance committee on the legislation this June. I would urge you to recommend that the House Ways & Means Committee pass this fix to the Tax Cut and Jobs Act.

**Full, Immediate Expensing of Capital Investments and Doubling of the 179 Expensing Cap:**

The enactment of the 179 Direct expensing provisions have been one of the most effective tax provisions to help Small Businesses make and deduct the costs of investing in their businesses. Matching the cash outlays with the tax deductions help Small Businesses manage their cash flows with their tax liabilities. The doubling of the 179 deductions and the immediate expensing provisions are a positive improvement to our tax system. The fact that these provisions are set to expire in 2025 should be addressed. They should be permanent to enable Small Businesses to do long term planning. The Tax Cut and Jobs Act did have some issues involving certain types of accelerated write-offs for certain types of properties that should be cleaned up in any Tax Reform 2.0 legislation.

*Testimony of Grafton "Cap" Willey  
On Behalf of the National Small Business Association*

**Research & Development Credits:**

Congress has played around with the Research & Development credits for years. There seems to be no understanding that research and development requires years of advance planning. The on again off again adjustments to the R&D credits wreaks havoc on R&D planning especially for Small Businesses. The current credit is preserved for now, but it is scheduled to change in 2021. The R&D Credit needs to be maintained and be consistent to allow for long term R&D planning in the future.

**Estate Tax Exemption:**

The Estate tax often is very much a small business issue. Non-Public Small Businesses are usually difficult to value and are an illiquid asset in the hand of the owners. The assessment of an estate tax on a small business often will put a substantial financial burden on the small business which will divert funds from being able to be reinvested into the business. We applaud the increase in the estate tax exemption, but we are concerned that the provision expires after 2025. These changes should be made permanent. We support the full repeal of the estate tax for Small Businesses and Family Farms.

**Raising the AMT Exemption:**

While raising the AMT exemption is an individual tax provision, it was affecting more and more people each year. The change was overdue. Again, this provision is not permanent, expiring in 2025. The AMT should be fully repealed. With the elimination of Miscellaneous deductions and the limitations on state and local taxes there is little need for an AMT Tax.

**Meals & Entertainment Expenses:**

Some concerns have been raised about the limitations of entertainment expenditures under the Tax Cut & Jobs Act. An argument can be made that Small Businesses rely more heavily on relationship building to obtain sales than larger businesses that can afford higher cost advertising and marketing expenditures that would be deductible. Personally, I have less concern about this limitation.

**Deficit Reduction and Control of Spending:**

While Small Business wants to be treated fairly in any Tax Reform, we are concerned about the burgeoning National Debt that is over \$20 Trillion and climbing steadily. A slight increase in the interest rates will substantially increase the cost of carrying this debt. People have talked about the Debt and the Deficit for years, but nobody seems to take it seriously pushing it down the

*Testimony of Grafton "Cap" Willey  
On Behalf of the National Small Business Association*

road for our children and grandchildren to deal with. It is an issue that needs to be dealt with on both the revenue side and the spending side.

#### **Overall Impact of the Tax Cut and Jobs Act on Small Businesses:**

Overall, I personally think that the Tax Cut and Jobs Act has had a positive impact on the US economy and on Small Businesses. However, NSBA's Survey speaks differently on this. Just one in three small business owners say that the Tax Cut and Jobs Act has been directly beneficial to their business, while one in ten say it will harm their businesses. The majority say that it is not impacting their businesses at all or they are not sure yet of any impact. Of the 35 percent of small business owners who say that the Tax Cut and Jobs Act has benefited their business, just half of those say that the benefit is in lower taxes while one in four say the legislation is increasing consumer spending in their business.

Complexity and inconsistency within the tax laws pose a significant and increasing problem for small businesses. The ever-growing patchwork of credits, deductions, tax hikes, and sunset dates is a roller coaster ride without the slightest indication of what is around the corner. To promote economic growth, job creation, capital formation, and international competitiveness, changes to the TCJA are required. However, unless and until Congress agrees upon a replacement, we must fix tax problems with the current law by developing simplification measures that are fair and fiscally responsible.

Coupled with a less aggressive regulatory environment Small Businesses are generally doing better financially and are cautiously optimistic looking forward. Being able to find qualified employees is sometimes a challenge which is a product of competition for workers in a good economy and somewhat reflected in shortfalls in our educational systems which are not producing the quality of students needed to succeed in the 21st century. (A topic for another day). How long this economy will continue to expand is always a concern?

In my practice I have found that on average individuals at most income levels have paid less in Federal income taxes than in previous years. Many may not feel that they have because their tax refunds may have been less than in previous years. Federal withholding tables were reduced early in 2018 which left a number of people under withheld which resulted in less of a refund or a balance due when they filed their tax returns. The real question should be; did they pay more or less taxes on their similar taxable income, not the size of their refunds?

*Testimony of Grafton "Cap" Willey  
On Behalf of the National Small Business Association*



Initial analysis has suggested that most of the tax benefits went to the higher income taxpayers. I am not seeing that impact. Those taxpayers with income from qualified businesses are showing tax savings but not to the extent that C-Corporations have benefited. I also see many wealthy taxpayers paying considerably more in tax under the new tax regime. Wealthy people that have multiple homes, high real estate and state income tax payments, high mortgages, and high miscellaneous deductions are paying much more in Federal income taxes. I have people paying \$50,000 to \$150,000 more under tax reform than they did under the old tax system. They have been surprised and not particularly happy about it.

In summary Small Business views, the Tax Cut and Jobs Act as a work in progress. Technical corrections should be made. Tax Reform should be followed up addressing the issues not addressed in this law. We need to have a tax system that is fair to all and promotes economic growth for all sectors of our economy. Small Business is an important economic driver that needs the full support of our legislative leaders.

Again, I would like to thank Chairwoman Velazquez and the members of the Small Business Committee for the opportunity to speak today. I would be happy to answer any questions that you may have.

Respectfully Submitted

Grafton H Willey, IV, CPA

*Testimony of Grafton "Cap" Willey  
On Behalf of the National Small Business Association*

**US House of Representatives**

**Committee on Small Business**

**Is the Tax Cut and Jobs Act a Help or a Hinderance to Main Street?**

**Testimony of Grafton H. Willey, IV CPA**

**July 24, 2019**

**Appendix**

Invitation to Testify

Truth in Testimony Disclosure Form

Grafton H Willey-CV

NSBA TAX REFORM-WHAT IT MEANS FOR SMALL BUSINESS-Tax Reform Report Card

NSBA Principles for Tax Reform

State of Rhode Island-2019 H-5576 Work around legislation for Pass-Through Entities-passed  
June 2019

Testimony of Grafton H Willey IV before the RI House Finance Committee on H-5576 Work  
around legislation for Pass-Through Entities

Press Release on filing of RI H-5576 by RI House Majority Leader Joseph Shekarchi 2/27/2019

*Testimony of Grafton "Cap" Willey  
On Behalf of the National Small Business Association*

## Truth in Testimony Disclosure Form

In accordance with Rule XI, clause 2(g)(5)\*, of the *Rules of the House of Representatives*, witnesses are asked to disclose the following information. Please complete this form electronically by filling in the provided blanks.

Committee: Small Business

Subcommittee: \_\_\_\_\_

Hearing Date: July 24, 2019 11:30am

Hearing Subject:

Is the Tax Cuts & Jobs Act a help or a Hinderance to Main Street?

Witness Name: Grafton H. Willey, IV

Position/Title: CPA and Small Business Owner

Witness Type: ☐ Governmental ☒ Non-governmental

Are you representing yourself or an organization? ☐ Self ☒ Organization

If you are representing an organization, please list what entity or entities you are representing:

National Small Business Association (NSBA), RI Society of CPA's

If you are a non-governmental witness, please list any federal grants or contracts (including subgrants or subcontracts) related to the hearing's subject matter that you or the organization(s) you represent at this hearing received in the current calendar year and previous two calendar years. Include the source and amount of each grant or contract. *If necessary, attach additional sheet(s) to provide more information.*

No Federal Grants

If you are a non-governmental witness, please list any contracts or payments originating with a foreign government and related to the hearing's subject matter that you or the organization(s) you represent at this hearing received in the current year and previous two calendar years. Include the amount and country of origin of each contract or payment. *If necessary, attach additional sheet(s) to provide more information.*

No contracts with foreign governments

### False Statements Certification

Knowingly providing material false information to this committee/subcommittee, or knowingly concealing material information from this committee/subcommittee, is a crime (18 U.S.C. § 1001). This form will be made part of the hearing record.

  
\_\_\_\_\_  
Witness signature

7/21/19

\_\_\_\_\_  
Date

**Please attach, when applicable, the following documents to this disclosure. Check the box(es) to acknowledge that you have done so.**

- ☐ Written statement of proposed testimony
- ☐ Curriculum vitae or biography

\*Rule XI, clause 2(g)(5), of the U.S. House of Representatives provides:

(5)(A) Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof.

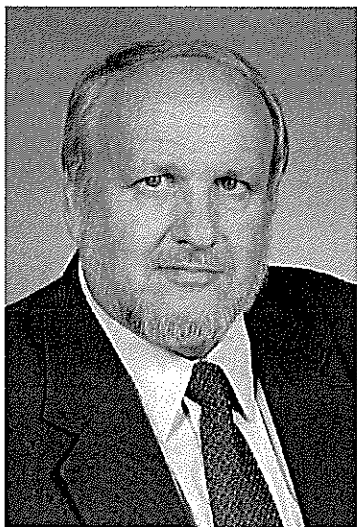
(B) In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of any Federal grants or contracts, or contracts or payments originating with a foreign government, received during the current calendar year or either of the two previous calendar years by the witness or by an entity represented by the witness and related to the subject matter of the hearing.

(C) The disclosure referred to in subdivision (B) shall include—

(i) the amount and source of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) related to the subject matter of the hearing; and

(ii) the amount and country of origin of any payment or contract related to the subject matter of the hearing originating with a foreign government.

(D) Such statements, with appropriate redactions to protect the privacy or security of the witness, shall be made publicly available in electronic form not later than one day after the witness appears.



## Grafton H. Willey, IV, CPA

Managing Director

One Citizens Plaza  
Providence, RI 02903  
401.626.3213  
gwilley@cbiz.com

### Professional Summary:

Grafton "Cap" is a member of the Tax Group. Prior to joining CBIZ & MHM, he was the Managing Shareholder of Rooney, Plotkin & Willey. Cap has more than 35 years of experience as a tax accountant and consultant to privately-held business owners.

He is an active advocate for small business issues at the state, regional, and national levels, and was twice selected as the Rhode Island Small Business Accounting Advocate of the Year and once as the Small Business Advocate of the Year by the National Small Business Association (NSBA).

### Education:

- Bachelor of Science, Syracuse University

### Professional Memberships:

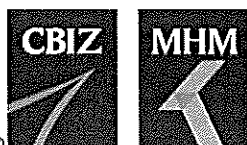
- American Institute of Certified Public Accountants
- Rhode Island Society of Certified Public Accountants, Taxation and Legislative Committees
- Massachusetts Society of Certified Public Accountants
- National Small Business Association (NSBA), Past Chair
- Smaller Business Association of New England (SBANE), Rhode Island Chapter Co-Chair
- Financial Accounting Standards Board (FASB), Small Business Advisory Committee 2006-2008
- Providence Chamber of Commerce, Legislative Committee
- Rhode Island Manufacturers Association (RIMA), member

### Civic Organizations:

- Providence Rotary Club
- Affordable Rhode Island Coalition
- The Rhode Island Foundation, Professional Advisory Council

### Awards and Honors:

- Recipient of the 2016 Rhode Island Society of CPA's Chairman's Award
- Named the 2011 Lewis Shattuck Small Business Advocate of the Year by the National Small Business Association
- Twice selected as the Rhode Island Small Business Accounting Advocate of the Year



# TAX REFORM

## WHAT IT MEANS FOR SMALL BUSINESS

In 2017, Congress passed, and President Trump signed into law, the Tax Cuts and Jobs Act. Here's what the bill included and what it didn't, as well as the remaining reforms that must be addressed.

### TAX REFORM REPORT CARD

Tax Reform Provisions	NSBA Rating	Outlook
Permanency of rate reductions and credits/deductions	★ ★ ★ ★ ★	Key small-business provisions expire, long-term reform a must-do by 2025
Lowers individual tax rates	★ ★ ★ ★ ★	Expires after 2025, needs to be made permanent and on-par with corporate rates
Simplify tax administration	★ ★ ★ ★ ★	Simplification not addressed for small business, major reform such as Fair Tax required
Full, immediate expensing of capital investments and doubles the Section 179 expensing cap	★ ★ ★ ★ ★	Expires after 2025, should be permanent
Parity between the tax rates of C-Corps and S-Corps	★ ★ ★ ★ ★	Lessened gap, but didn't eliminate disparity between large corporations and small business – full parity needed
Lowers corporate tax rate from 35 percent to 21 percent	★ ★ ★ ★ ★	Permanent, impacts less than 17 percent of small businesses
Small business tax deduction of 20 percent for certain pass-through business income	★ ★ ★ ★ ★	Expires after 2025, needs fix to achieve permanency and parity with corporate rates
Reduce the deficit	★ ★ ★ ★ ★	Major spending cuts needed to balance cuts in revenue – resulting economic growth not enough
Doubles estate tax exemption to \$10 million	★ ★ ★ ★ ★	Expires after 2025, should be fully repealed
Raises AMT exemption and increases the phase-out threshold to \$1 million	★ ★ ★ ★ ★	Expires after 2025, should be fully repealed
Bonus depreciation increased to 100 percent	★ ★ ★ ★ ★	Phase-down starts 2024, should be made permanent
Preserves the R&D tax credit	★ ★ ★ ★ ★	R&D expenses to be amortized after 2021, should be permanent

At the end of the day, NSBA supported the Tax Cuts and Jobs Act—not because it was perfect, but because it was a good start. Lawmakers still have heavy lifting to do, including tax simplification, parity in taxation between large and small businesses, doing away with sunsets and making tax reform permanent, and addressing the deficit. ”



**Todd McCracken**  
President and CEO  
NSBA

### KEY

NSBA SUPPORTED, BILL FULLY ADDRESSED



NSBA SUPPORTED, BILL DIDN'T GO FAR ENOUGH



NSBA SUPPORTED, NOT A PRIORITY



PROVISION NOT FULLY ADDRESSED BY TAX CUTS AND JOBS ACT



PROVISION EXCLUDED IN TAX CUTS AND JOBS ACT

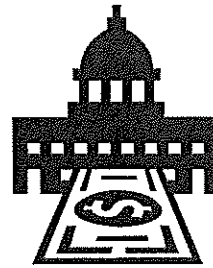


Please visit [www.nsba.biz/tax](http://www.nsba.biz/tax) for NSBA's detailed position statements and issue briefs.

# NSBA'S PRINCIPLES FOR TAX REFORM

Even with the reforms in the Tax Cuts and Jobs Act, more must be done to ensure simplification, fairness and long-term sustainability.

1. Designed to tax only once
2. Stable and predictable
3. Visible to the taxpayer
4. Simple in its administration and compliance
5. Promote economic growth and fairness between large & small businesses
6. Use commonly understood finance/accounting concepts
7. Grounded in reality-based revenue estimates
8. Fair in its treatment of all citizens
9. Transparent



60% of small businesses say **administrative burdens ARE A BIGGER PROBLEM** than the financial cost of federal taxes



83% of small firms are **pass-through entities**



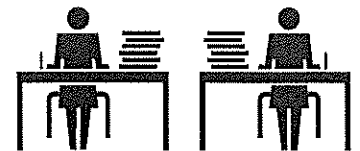
1-in-3 small businesses spend **more than \$5,000** on just the administration of federal taxes



**68%** of small firms use an external tax practitioner

Just 10% of small firms anticipate filing taxes under the Tax Cuts and Jobs Act will be easier.

The majority of small businesses say taxes have a **moderate-to-significant impact** on the day-to-day operation of their business.



**The National Small Business Association is the country's longest running small-business organization, operating on a staunchly nonpartisan basis with more than 65,000 small-business members.**

STATE OF RHODE ISLAND

IN GENERAL ASSEMBLY

JANUARY SESSION, A.D. 2019

A N A C T

RELATING TO TAXATION -- BUSINESS CORPORATION TAX

Introduced By: Representatives Shekarchi, Ackerman, Lima, Kazarian, and Noret

Date Introduced: February 27, 2019

Referred To: House Finance

It is enacted by the General Assembly as follows:

1           SECTION 1. Chapter 44-11 of the General Laws entitled "Business Corporation Tax" is  
2 hereby amended by adding thereto the following section:

3           44-11-2.3. Pass-through entities -- Election to pay state income tax at the entity level.

4           (a) Definitions. As used in this section:

5           (1) "Election" means the annual election to be made by the pass-through entity by filing  
6 the prescribed tax form and remitting the appropriate tax.

7           (2) "Net income" means the net ordinary income, net rental real estate income, other net  
8 rental income, guaranteed payments, and other business income less specially allocated  
9 depreciation and deductions allowed pursuant to § 179 of the United States Revenue Code (26  
10 U.S.C. § 179), all of which would be reported on federal tax form schedules C and E. Net income  
11 for purposes of this section does not include specially allocated investment income or any other  
12 types of deductions.

13           (3) "Owner" means an individual who is a shareholder of an S Corporation; a partner in a  
14 general partnership, a limited partnership, or a limited liability partnership; a member of a limited  
15 liability company, a beneficiary of a trust; or a sole proprietor.

16           (4) "Pass-through entity" means a corporation that for the applicable tax year is treated as  
17 an S Corporation under I.R.C. 1362(a) (26 U.S.C. § 1362(a)), or a general partnership, limited  
18 partnership, limited liability partnership, trust, limited liability company or unincorporated sole  
19 proprietorship that for the applicable tax year is not taxed as a corporation for federal tax



1 purposes under the state's regulations.

2 (5) "State tax credit" means the amount of tax paid by the pass-through entity at the entity  
3 level which is passed through to an owner on a pro rata basis.

4 (b) Elections.

5 (1) For tax years beginning on or after January 1, 2019, a pass-through entity may elect to  
6 pay the state tax at the entity level at the rate of five and ninety-nine hundredths percent (5.99%).

7 (2) If a pass-through entity elects to pay an entity tax under this subsection, the entity  
8 shall not have to comply with the provisions of § 44-11-2.2 regarding withholding on non-  
9 resident owners. In that instance, the entity shall not have to comply with the provisions of § 44-  
10 11-2.2 regarding withholding on non-resident owners.

11 (c) Reporting.

12 (1) The pass-through entity shall report the pro rata share of the state income taxes paid  
13 by the entity which sums will be allowed as a state tax credit for an owner on his or her personal  
14 income tax return.

15 (2) The pass-through entity shall also report the pro rata share of the state income taxes  
16 paid by the entity as an income (addition) modification to be reported by an owner on his or her  
17 personal income tax returns.

18 (d) Net taxable income for purposes of this subsection shall be calculated in accordance  
19 with § 44-11-2.4(a)(3), subject to applicable apportionment rules for businesses operating in  
20 multiple states.

21 (e) State tax credit shall be the amount of tax paid by the pass-through entity, at the entity  
22 level, which is passed through to the owners, on a pro rata basis.

23 (f) A similar type of tax imposed by another state on the owners' income paid at the state  
24 entity level shall be deemed to be allowed as a credit for taxes paid to another jurisdiction in  
25 accordance with the provisions of § 44-30-18.

26 (g) "Combined reporting" as set forth in § 44-11-4.1 shall not apply to reporting under  
27 this section.

28 SECTION 2. This act shall take effect upon passage.

=====  
LC001711  
=====

EXPLANATION  
BY THE LEGISLATIVE COUNCIL  
OF  
A N A C T  
RELATING TO TAXATION -- BUSINESS CORPORATION TAX

\*\*\*

1           This act would provide for a pass-through entity tax to shift the income tax liability from  
2   an entity's owner to the entity itself. The tax would be deductible by the entity thereby helping to  
3   offset the effect of the ten thousand dollar (\$10,000) limit on an individual's state and local tax  
4   (SALT) deductions by reducing their share of overall allocable income.

5           To ensure against double taxation, the act would provide owners with a tax credit to  
6   offset the tax on their share of the entity's after pass-through entity tax income.

7           This act would take effect upon passage.

=====  
LC001711  
=====

RI House Finance Committee  
2019 H 5576  
Pass-Through Entities Proposal  
Testimony of Grafton "Cap" Willey, IV  
May 1, 2019

My name is Grafton H. Willey, IV but most people know me as Cap Willey. I represent the RI Society of CPA's, the RI Business Coalition and the Providence Chamber of Commerce on this legislation.

I am entitling my testimony as Pass-Through Taxation for Dummies with no offense meant to the Committee members. Taxation can be complex which is why I have a job. Hopefully I can explain this for the non-professional. This legislation is unique in proposals before your Committee in that it is revenue neutral to the State and could help many RI small business in reducing their Federal income taxes.

As most of us are aware the Trump Tax Reform which took effect for 2018 limits the deductions for state and local taxes for individuals to \$10,000 which has hurt many high tax states like RI. Many of you may have realized that as you prepared your 2018 income taxes this year.

Tax Reform does allow for the deduction of State and Local taxes assessed on business income if paid by the business entity. C-Corporations can deduct state and local taxes in determining their taxable income without a problem.

Most small businesses in RI operate as pass-through entities, primarily because of the single level of tax on an exit versus a C-Corp that would pay a double tax on a sale, one at the corporate level and another at the individual level.

Pass-through entities do not pay taxes at the entity level, they pass their income down to the owners who pay individual taxes on their personal returns. The State income taxes of a pass-through paid by the individual would be limited to the \$10,000 which would include other state and local taxes such as real estate taxes. Most small business pass-through's would not get the benefit of the federal deduction for the state business income taxes. This sets up a parity issue for pass-through's. C-Corporations (usually big businesses) get the deductions for state and local income taxes while S-Corporations and other pass-through would not get a deduction.

This legislation would allow a pass-through entity to elect to pay the state income tax at the entity level the same as a c-Corporation and deduct it from the Federal income that is passed to

the owners. The net benefit is that it allows the pass-through entity to be treated the same as the larger C-Corporation on their income which is only fair.

From the State's perspective this should be revenue neutral. The State will collect the same amount from the individual or the pass-through as it would before the legislation. It provides the pass-through with the ability to get a Federal tax deduction for the payment of the state income taxes on the business income which should help many small businesses.

It also helps the State in its collection efforts by having the entity pay the state taxes and not having to chase all of the individual owners on their personal returns. It also eliminates the need to have only the non-resident owners have withholding taken out of their income distributions.

It should be a win-win for the State and for the pass-throughs.

There is a possibility that the IRS might fight this approach. They have disallowed the deductions for real estate taxes reclassified as charitable contributions which does not work legally. This legislation is effective for years beginning in 2019. Connecticut has passed somewhat similar legislation effective for 2018 so we will have an opportunity to see if this survives any IRS attack. So far the IRS has not seemed to have found a way to attack it. Our fallback position if faced with an adverse decision would be to have the State of RI not recognize pass-throughs for state income tax purposes, assess the tax at the entity level and exclude the income from RO taxes. This approach might be a little more difficult to make revenue neutral.

As stated above, Connecticut has passed similar legislation. Wisconsin has a new law effective for 2019. Oklahoma just signed their similar law this week which looks like it is modeled after our proposal. There are proposals in Arkansas and Michigan under consideration. I have been in contact with the US House Ways & Means Chairman recently to see if this can be corrected on a Federal level and they are interested in looking at it. The problem there is whether or not anything can be passed in Washington under the current political environment. In the meantime we should see what we can do in RI to help RI small businesses. I strongly urge that you pass this legislation.

Respectfully Submitted:

Grafton H. Willey, IV

Feb. 27, 2019

MRW

Majority Leader Shekarchi at (401) 827-0100

## **Shekarchi files bill to protect small businesses hurt by Trump's tax changes**

STATE HOUSE – House Majority Leader K. Joseph Shekarchi has introduced legislation to help the many Rhode Island small business owners who will be hit by higher federal taxes under President Trump's new tax laws.

The bill will provide a work-around for owners of "pass-through" entities whose state and local taxes exceed the new \$10,000 cap on the state and local tax (SALT) deduction on their federal tax returns. The effort, which is based on a similar bill enacted in Connecticut in May, is carefully designed to pass IRS muster and be revenue-neutral for the state.

"This is a way to help Rhode Island small businesses at no cost to the state. Our small businesses are the backbone of our economy, and face enough challenges without being saddled with new tax burdens by President Trump's tax plan. We've found a viable method to help their owners get credit for the taxes they already pay, so their businesses are not disrupted, forced to make cuts to their workforce or worse, to close," said Leader Shekarchi (D-Dist. 23, Warwick). "My goal here is to prevent the Trump tax plan from hurting small businesses, so they can thrive here in Rhode Island."

Since 1913, federal taxpayers have been allowed to deduct the full amount of their state and local taxes from their federal taxable income under the SALT deduction. However, the Tax Cuts and Jobs Act, pushed by President Trump and passed by Congress in December 2017, now limits the SALT deduction to \$10,000 for tax years 2018 through 2025. This could add up to a significant increase in tax liability for many taxpayers across the nation and in Rhode Island.

In Rhode Island, 33 percent of filers use that credit, and, on average, they claimed \$12,434 in 2015, according to research by Pew Charitable Trusts. The organization lists Rhode Island as one of 19 states where the average SALT credit exceeds the new \$10,000 cap.

The legislation allows pass-through entities, such as limited liability companies (LLCs) and S corps, to pay the federal tax on their own income, instead of passing it along to their partners to claim on their personal income tax returns, as is the usual practice. The bill also allows a credit the partners can take on their personal and corporate state income tax returns to ensure that the business's income isn't taxed twice. If passed, the changes would take effect for the 2019 tax year.

Leader Shekarchi developed the bill with the help Grafton "Cap" Willey IV, a prominent Providence CPA, who approached Leader Shekarchi with an idea brought to him by a fellow member of his Rotary Club.

"This bill will help small businesses, most of whom report their taxes as pass-through entities, by having the business entity pay the taxes on the business income and allowing a federal income tax deduction – which might have been limited if reported on the owner's personal income tax returns," said Willey. "Regular C-Corporations get this benefit, and this bill would put the pass-through entities on an equal footing with big businesses."

Leader Shekarchi introduced the bill in the House of Representatives Tuesday.

*For an electronic version of this and all press releases published by the Legislative Press and Public Information Bureau, please visit our website at [www.rilegislature.gov/pressrelease](http://www.rilegislature.gov/pressrelease).*