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"Small Business Tax Reform: Modernizing the Code for the Nation's Job Creators"

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Committee on Small Business

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Members of the Committee and staff, thank you for the invitation to testify today. My name is Caroline Bruckner and I am a tax professor on the faculty at American University's Kogod School of Business. I am also the Managing Director of American University's Kogod Tax Policy Center (KTPC), which conducts nonpartisan policy research on tax and compliance issues specific to small businesses and entrepreneurs. I am particularly appreciative of the opportunity to return to testify before this Committee to share my views on H.R. 3717, the *Small Business Owners' Tax Simplification Act of 2017*. H.R. 3717 is a bill that I worked with Committee staff to develop that includes essential tax code changes designed to address sharing economy tax compliance challenges I brought to this Committee's attention when I testified in May 2016, on the findings of my research included in *Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy*. I am pleased to discuss provisions of H.R. 3717 that address existing tax compliance challenges identified in my research as well as provide insight on other areas the Committee should consider in moving forward with ideas for tax reform to help America's small businesses grow and access capital.

Part I – H.R. 3717: A Commonsense Approach to Tax Simplification for Small Businesses

Introduced as a bipartisan bill, H.R. 3717 proposes commonsense changes to better meet the needs of the growing number of sharing economy operators and self-employed small business owners. The changing nature of today's workforce and growing number of self-employed small business owners warrant these changes. As this Committee heard in testimony last year from the National Taxpayer Advocate, Nina Olson, "the self-employed have been growing faster than any other small business group over the past 10 years."[1] H.R. 3717 provides simplification and tax relief to small businesses navigating the uncertainty of the current tax code, particularly those taxpayers who are subject to the quarterly-estimated payment rules, the Form 1099 reporting rules, and self-employed small business owners paying for their own healthcare coverage.

Notably, H.R. 3717 reflects this Committee's ongoing commitment to address the tax challenges that plague the smallest of small business owners and that are a barrier to their growth. This bill is the result of more than a year-long effort, led by Kimberly Pinter, to develop small business tax relief legislation by soliciting feedback and policy ideas in countless phone calls, meetings, and exchanges with IRS and Treasury officials, small business tax policy experts, multiple Congressional committees including Ways and Means, Senate Finance and JCT, as well as stakeholders and small business owners from across the political spectrum. In addition, this Committee has held multiple full and subcommittee hearings to develop testimony from experts and small business owners with respect to the policy changes contemplated in this bill. As a result, H.R. 3717 represents commonsense tax simplification changes that will help millions of small business owners across the country.

In particular, three provisions of the bill stand-out as good examples of the bill's approach: the changing of the due dates for quarterly-estimated payments; the proposed alignment of the Form 1099-K and 1099-MISC filing income thresholds; and the reinstatement of the deduction for health insurance costs for the self-employed.

I. Quarterly-Estimated Payments

Last year I reported to this Committee that in our survey of experienced, self-employed business owners operating in the sharing economy, more than one-third of respondents did not know whether they were required to file quarterly-estimated payments on the income they earned working with a platform.[2] Two days later, the National Taxpayer Advocate testified before this Committee and recommended that anything that can be done "to help taxpayers make their estimated tax payments more easily and lessen the burden of saving to make such payments is likely to increase compliance." H.R. 3717 does just that. By updating the filing deadlines for second and third quarter installment payments set forth in IRC Section 6654(c) to be due two weeks after a quarter's end, rather than in the middle of a quarter as is required under current law, H.R. 3717 modernizes the existing filing deadlines to reflect business reality of the second and third quarters' end. As a result, this change is likely to increase compliance because under current law "taxpayers must remember oddly spaced payment dates…[that] do not consistently coincide with calendar quarters, making difficult to calculate net income and confusing to tax payers."[3] By simply changing existing due dates to fall after a quarter's end, H.R. 3717 can ease the burdensome process of estimating income for purposes of remitting quarterly-estimated payments because taxpayers will know how much they earned the preceding quarter rather than requiring taxpayers to make their best guess.

II. Alignment of 1099 Filing Thresholds

In addition, H.R. 3717 proposes long-overdue updates to the Form 1099 filing thresholds that are needed to keep pace with growth trends in our economy. In May 2016, I testified that expert economists have found that the explosive growth of the on-demand platform economy is the latest example of a 66.5% increase in alternative work arrangements for U.S. workers that increased from 14.2 million in 2005 to 23.6 million in 2015.[4] Moreover, with respect to the sharing economy, my research found that more than 60% of the sharing economy operators I surveyed did not receive any Form 1099 on their platform income and that almost 70% received no tax guidance from the sharing economy platform they worked with. Our research suggested that persistent tax compliance challenges attributable, in part, to an antiquated information reporting regime would only continue to grow along with alternative contingent work arrangements and the sharing economy. The most recent IRS taxpayer data released this year confirmed the ultimate impact of our research findings: for 2015, the number of filers penalized for underpaying estimated taxes rose nearly 40% between 2010 and 2015—to 10 million from 7.2 million.[5]

However, in response to the release of Shortchanged, significant work has been done by both the IRS and industry to help sharing economy operators navigate the complexity of the tax code. For example, in August 2016, the IRS launched the Sharing Economy Tax Center on IRS.gov "to help taxpayers involved in the sharing economy quickly locate the resources they need to help them meet their tax obligations."[6] In addition, some industry platforms began issuing Form 1099-Ks to sharing economy operators even though it was not required under current law to help operators meet their tax filing obligations.[7]

H.R. 3717 takes the next step by proposing the commonsense alignment of the filing thresholds for information reporting to the IRS and taxpayers for Forms 1099-MISC and 1099-K. Under current law, a Form 1099-MISC is required on amounts paid by nonemployers to service providers and sellers generally on amounts of $600, however, if a payment is made via a credit card or debit card, a Form 1099-K is required.[8] In cases where a Form 1099-K is required, a taxpayer must have more than 200 transactions *and* payments exceeding $20,000 before the Form 1099-K reporting rules are triggered. As a result of the 200 transaction/$20,000 income thresholds for Form 1099-K filings, the majority of small business operators earning income working with sharing economy platforms are not guaranteed to receive a Form 1099-K because, on average, they earn substantially less than $20,000 per year.[9] Our survey and research confirmed this state of play.

By lowering the filing threshold for Form 1099-K to $1,500, H.R. 3717 actively works to ensure at the very least taxpayers have the forms they need to file their taxes and claim any deductions or credits they may be entitled to in order to lower their tax liability. At the same time, H.R. 3717 modernizes the Form 1099-MISC threshold by raising it from $600 to $1,500 to provide some relief for small businesses who are subject to the Form 1099-MISC filing rules. Keep in mind, the Form 1099-MISC filing thresholds have not been fundamentally reviewed or updated since at least 1954.[10] Adjusted for inflation, $600 in 1954 would be more than $5,000 in today's dollars. By creating a uniform reporting standard for filing for Form 1099-MISC and Form 1099-K, H.R. 3717 is likely to enhance compliance by both taxpayers and reporting entities because more taxpayers will receive Form 1099s, which is abundantly supported by the existing research on tax compliance challenges of sharing economy operators and will likely benefit other self-employed small business owners operating outside the sharing economy, but who primarily are paid via credit card transactions. In short, H.R. 3717 simplifies and modernizes the information reporting regime in a fundamental way that is likely to reduce the confusion and unnecessary complexity of we identified in our report, and also will likely increase compliance by small business operators many of whom are in the sharing economy, and more than 23 million of whom are now in alternative contingent work arrangements.

III. Tax Equity for the Self-Employed

Finally, H.R. 3717, among other changes to help small businesses with their health insurance costs, proposes the reinstatement of the deduction for health care costs for the self-employed that was temporarily available as part of the 2010 Small Business Jobs Act.[11] This Committee has taken countless hours of testimony from small business owners across the country who struggle with paying for healthcare insurance. The self-employed small business owner is particularly challenged as they are unable, under current law, to deduct the full-extent of their healthcare costs. For 2010 only, self-employed small business owners were allowed to deduct their healthcare costs for purposes of calculating self-employment taxes. As my fellow panelist Kristie Arslan testified before the U.S. Senate Committee on Small Business and Entrepreneurship (Senate SBC) in 2011 at a hearing I organized as the General Counsel of the Senate SBC, this deduction had a real impact on lowering taxes for the self-employed:

> "What did this deduction mean to someone who is self -employed? Health insurance and taxes are the two highest costs for small business. Annual premiums in the individual market averaged $2,985 for single coverage and $6,328 for family plans nationwide in mid-2009, according to a report released by America's Health Insurance Plans (AHIP). Based on these costs, the one-year tax deduction in the Small Business Jobs Act of 2010 saved self-employed business owners approximately $456.71 to $968.14 in taxes. Depending on the cost of their health coverage, some businesses likely saved even more."[12]

The reinstatement of this deduction is an example of tax simplification that can, and will, actual lower tax bills for America's self-employed small business owners, who we know struggle with rising health care costs. This provision has long enjoyed support of both parties and has been championed by the current Chair of the Senate Finance Committee.[13]

Part II – Congress Need to Do More to Address Tax Challenges of Small Businesses Struggling to Grow and Access Capital

H.R. 3717 is commonsense approach to addressing tax challenges faced by America's small businesses. But I urge the Committee to do more. As Congress moves forward with tax reform, this Committee will continue to play a vital role in informing members and the tax-writing committees on tax and compliance challenges facing small businesses under the current system, however, with respect to women-owned firms, there is significantly more work to be done.

Specifically, our latest research, *Billion Dollar Blind Spot – How the U.S. Tax Code's Small Business Tax Expenditures Impact Women Business Owners*, which we released in June, identifies a number of barriers to small business growth that impact women-owned firms, the overwhelming majority of which are small businesses. Moreover, our report assesses how the U.S. tax code's more than $255 billion of tax expenditures targeted to help small businesses grow and access capital impact women-owned firms and makes the following findings.

- While women-owned firms have increased to now total more than 11 million (or 38% of all U.S. firms), the majority of women business owners are small businesses operating in service industries and they continue to have challenges growing their receipts and accessing capital.
- At the same time, three of the four small business tax expenditures we assessed are so limited in design that they either (i) explicitly exclude service firms, and by extension, the majority of women-owned firms; or (ii) could effectively bypass women-owned firms who are not incorporated or who are service firms with few capital-intensive equipment investments altogether.
- Our survey data of 515 experienced, engaged women business owners corroborates these findings, and nevertheless suggests that when women-owned firms can take advantage of tax breaks, they do. However, neither Congress nor Treasury or IRS or SBA has ever measured how the tax code impacts women business owners.
- For example, we identified only three women business owners who had ever used Internal Revenue Code Section 1202 - a $6 billion tax break - to raise capital for their firms. While we expect that more than three women-owned firms have used this provision since 1993, we don't have publicly-available taxpayer data to prove it. This example highlights why we need tax research on women business owners. Similarly, our survey found that women business owners use Section 179 at significantly lower rates than existing government research finds for businesses generally. This tax break is one of the most expensive (i.e., it will cost $248 billion from 2016-2020), and yet we don't have any research on how it benefits women business owners.
- Our findings raise questions as to (i) whether the U.S. tax code's small business tax expenditures are operating as Congress intended for these small businesses; and (ii) whether the cost of these expenditures has been accounted for in terms of their uptake by women-owned firms.

In answering these questions impacting millions of women business owners, we found that Congress and stakeholders have a billion dollar blind spot when it comes to understanding how effective small business tax expenditures are with respect to women-owned firms. This blind spot indicates Congress does not have data or research to make evidence-based tax policy decisions with respect to these small businesses. Ultimately, we recommend the following strategies for this Committee to employ to develop necessary research on these issues including:

1. Requesting the Congressional tax-writing committees hold joint hearings together with this Committee on the small business tax issues identified in *Blind Spot*;

2. Requesting the Joint Committee on Taxation develop estimates on how small business expenditures impact women-owned firms; and
3. Requesting the federal Commission on Evidence-Based Policymaking develop strategies for developing the data we need to measure these expenditures in terms of women-business owners.

Congress, and specifically this Committee, has demonstrated time and again its commitment to alleviating the tax burdens faced by small businesses. So much so, that under current law, taxpayers will forego more than $255 billion from 2016 to 2020 just on the four small business tax expenditures assessed in our latest research. And yet there has been no formal accounting as to whether and how these expenditures impact or are distributed to or among women-owned firms—99% of which are small businesses, according to SBA's Office of Advocacy's latest report on women-owned firms. As a result, Congress doesn't know whether the money it has spent trying to help smaller firms access capital and grow has been well spent with respect to women-owned firms. The absence of research on these issues is contrary to recent Congressional efforts to engage in evidenced-based policy making going forward and means Congress does not have adequate data to understand the barriers to growth impacting more than 11 million small businesses. This Committee can and should immediately work to develop the needed research to understand the tax barriers facing these small businesses.

Finally, I urge the Committee to continue to consider what more can be done to expedite help for the millions of small business owners in Texas, Florida, Puerto Rico and the Virgin Islands impacted by the devastating 2017 hurricane season. As a native Houstonian, I went home just last week to be with friends and family, survey the damage, and volunteer with recovery efforts. As someone who started working on disaster recovery issues on behalf of the state of Louisiana four years after Hurricane Katrina made landfall, I know from experience that it will be the small businesses in impacted communities that will lead the recovery and that it will take years for many of these communities to recover. To date, I have heard from people in DC and in Houston that SBA and FEMA are doing good work, however, there is more work to be done and I strongly urge the Committee to prioritize any necessary SBA disaster recovery legislation. Again, I thank you for the opportunity to join today's discussion and for the work you do on behalf of America's small businesses.

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[1] *The Sharing Economy: A Tax Experience for New Entrepreneurs Part II: Hearing Before the House Comm. on Small Business*, 113th Congress (2016)(statement of Nina Olson, IRS National Taxpayer Advocate) *available at* https://smallbusiness.house.gov/uploadedfiles/national_taxpayer_advocate_testimony-5-26-2016_hearing.pdf.

[2] *The Sharing Economy: A Tax Experience for New Entrepreneurs Part I: Hearing Before the House Comm. on Small Business*, 113th Congress (2016)(statement of Caroline Bruckner, Managing Director, Kogod Tax Policy Center) *available at* https://smallbusiness.house.gov/uploadedfiles/5-24-16_bruckner_testimony_.pdf.

[3] Oslon, *supra* n. 1.

[4] Lawrence F. Katz & Alan B. Krueger, *The Rise and Nature of Alternative Work Arrangements in the United States, 1995-2015*, (Mar. 29, 2016), http://scholar.harvard.edu/files/lkatz/files/katz_krueger_cws_v3.pdf?m=1459369766.

[5] Laura Saunders, "Number of Americans Caught Underpaying Their Taxes Surges 40%." *Wall Street Journal*, (Aug. 11, 2017) *available at* https://www.wsj.com/articles/the-numberof-americans-caught-underpayingsometaxes-surges-40-1502443801.

[6] Press Release, IRS, IRS Launches New Resource Center on IRS.gov, Provides Tips for Emerging Business Area (Aug. 22, 2016) *available at* https://www.irs.gov/businesses/small-businesses-self-employed/sharing-economy-tax-center.

[7] TurboTax – Taxes Income Tax, HOW TO USE YOUR LYFT 1099: TAX HELP FOR LYFT DRIVERS INTUIT TURBOTAX (2016), https://turbotax.intuit.com/tax-tools/tax-tips/Self-Employment-Taxes/How-to-Use-Your-Lyft-1099--Tax-Help-for-Lyft-Drivers/INF31027.html (last visited Oct 1, 2017).

[8] *See* Caroline Bruckner, Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy, American University Kogod Tax Policy Center (May 2016) (summarizing the information reporting rules for sharing economy operators).

[9] *Id*. According to the most comprehensive research available on the earnings of on-demand platform economy operators, the average monthly income of an on-demand platform small business ranges from $533 to $314 (roughly $6,396 to $3,700 annually). *See* Diana Farrell & Fiona Greig, *Paychecks, Paydays, and the On-demand Platform Economy: Big Data on Income Volatility*, JP Morgan Chase & Institute, 1-43 (2016), https://www.jpmorganchase.com/corporate/institute/document/jpmc-institute-volatility-2-report.pdf.

[10] See P.L. 83-591, which was enacted on Aug. 16, 1954 and which created IRC Section 6041 with the original $600 threshold.

[11] P.L. 111-240.

[12] Small Business Recovery: Progress Report on Small Business Jobs Act of 2010 Implementation, 112 Congress (2011) (statement of Kristie L. Arlsan, Executive Director, National Association for the Self-Employed) *available at* https://www.nase.org/sf-docs/default-source/advocacy-documents/NASE_Testimony-_SSBC-_Small_Business_Jobs_Act_Implementation-_Kristie_Arslan_05-19-11.pdf?sfvrsn=0

[13] S. 3348, 102nd Cong. § 101 (1992).