

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: October 2, 2017
Re: Hearing: "Small Business Tax Reform: Modernizing the Code for the Nation's Job Creators"

On Wednesday, October 4, 2017 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 United States tax code affects small businesses and how changes proposed in H.R. 3717, the "Small Business Owners' Tax Simplification Act of 2017," could impact the nation's job creators. H.R. 3717 is a bipartisan small business tax bill introduced by Chairman Steve Chabot (R-OH) and Ranking Member Nydia Velázquez (D-NY) as a result of numerous hearings and research. The hearing will provide the opportunity for Members of the Committee to hear directly from small businesses and private sector experts.

I. Introduction

With more than 29 million small businesses in the United States,¹ America's smallest firms continue to shape and transform communities in every state. From barber shops to manufacturers, these businesses employ nearly fifty percent of all private sector workers.² Not only are they job creators, but small businesses also act as the fuel for the economy. Estimates suggest that, as recently as 2008, small businesses contributed 46 percent of the private nonfarm gross domestic product (GDP).³ Main Streets across the country are filled with startups, entrepreneurs, and small businesses striving to become the next great American company.

As technology changes and advances, America's small businesses are also modifying how they operate. While traditional businesses models are still performing, today's businesses are transforming how they connect with customers. Online and internet applications, more commonly known as apps, along with smart phones, have streamlined the process for exchanging commercial goods and services. From identifying contractors for home repairs to locating vacation home rentals, the sharing economy⁴ is increasing efficiencies for all parties

¹ SBA OFFICE OF ADVOCACY, SMALL BUSINESS PROFILE (2017), available at https://www.sba.gov/sites/default/files/advocacy/United_States_1.pdf.

² *Id.*

³ KATHRYN KOBE, ECONOMIC CONSULTING SERVICES, SMALL BUSINESS ADMINISTRATION, SMALL BUSINESS GDP: UPDATE 2002-2010 (2012) at 4.

⁴ For a comprehensive overview of the sharing economy, please review *The Sharing Economy: A Taxing Experience for New Entrepreneurs, Part I and Part II* (May 2016), available at <https://smallbusiness.house.gov/calendar/eventsingle.aspx?EventID=399146>.

involved. More pointedly, *The Economist* describes how technology is driving the sharing economy as having “reduced transaction costs, making sharing assets cheaper and easier than ever—and therefore possible on a much larger scale.”⁵ The technology revolution that we are experiencing is poised to gain momentum and influence economies for years to come. According to projections made by PricewaterhouseCoopers, the sharing economy will grow by over 2,000 percent within a decade from approximately \$15 billion in revenues to \$335 billion in revenues by the year 2025.⁶

II. Tax Reform and Small Businesses

Conversations and debate surrounding comprehensive tax reform, which haven’t produced significant changes in over 30 years,⁷ provide an opportunity for small businesses to engage and level the playing field. There is no denying the impact small businesses have on the economy. As described above, small businesses are the engines of the economy producing the majority of new private sector jobs.⁸ When small businesses are creating jobs and expanding, so does the American economy.

However, the United States tax code continues to present obstacles to small business that prevent growth. The nation’s smallest firms are at a disadvantage compared to large companies who often employ large contingents of tax lawyers and accountants to handle their taxes and issues that arise from the Internal Revenue Service (IRS). Small businesses, on the other hand, must put off operating and growing their companies that line Main Street, America to spend time and resources to address tax issues.

Testimony provided by the Government Accountability Office (GAO) to the House Small Business Committee in 2015 noted that the tax burden for a company when calculated per dollar of assets or per employee disadvantages smaller firms. Per the testimony, “according to IRS, corporations and partnerships with 1 to 5 employees have an estimated tax compliance burden of \$4,308 to \$4,736 per employee, but corporations and partnerships with more than 50 employees have a much lower estimated per employee burden—\$182 to \$191.”⁹ In short, it costs small businesses more than large businesses to calculate their taxes.

Furthermore, recent research conducted by the National Federation of Independent Business (NFIB) shows that when small businesses were asked to rank their top concerns, approximately half of the top ten results dealt with tax issues.¹⁰ From federal taxes on business income to frequent changes in federal tax laws and rules,¹¹ small businesses continue to face

⁵ *The Rise of the Sharing Economy*, THE ECONOMIST (Mar. 2013).

⁶ *The Sharing Economy: Consumer Intelligence Series*, PRICEWATERHOUSECOOPERS, (2014) 14 available at <https://www.pwc.com/us/en/industry/entertainment-media/publications/consumer-intelligence-series/assets/pwc-cis-sharing-economy.pdf>.

⁷ Pub. L. No. 99-514 (1986).

⁸ SBA, OFFICE OF ADVOCACY, FREQUENTLY ASKED QUESTIONS (2017), available at <https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2017-WEB.pdf>.

⁹ *Small Businesses, IRS Considers Compliance Burden in Tax Administration, but Needs a Plan to Evaluate Its Payment Card Information Pilot: Hearing Before the H. Comm. on Small Business*, 114th Congress, First Session (2015) (testimony of J. Christopher Mihm), available at <http://www.gao.gov/products/GAO-15-754T>.

¹⁰ HOLLY WADE, NFIB SMALL BUSINESS PROBLEMS AND PRIORITIES 12 (2016), available at <http://www.nfib.com/assets/NFIB-Problems-and-Priorities-2016.pdf>.

¹¹ *Id.*

complexity and uncertainty when administering their taxes. Simply put, the tax code is not built for small businesses. It disadvantages them and strains their ability to attract and retain the best workers.

Moreover, technology and web-based apps are transforming how firms conduct business. Innovations have provided an opportunity for workers to be more independent and flexible with their time. Unfortunately, our laws have not kept pace with these advancements.¹² The flexibility created by the sharing economy creates uncertainty for many as the classification of a worker becomes paramount.

III. Updating the Code

In an effort to address the hurdles that small businesses face, House Small Business Committee Chairman Steve Chabot (R-OH) and Ranking Member Nydia Velázquez (D-NY) introduced H.R. 3717, the “Small Business Owners’ Tax Simplification Act of 2017,”¹³ with the goal of simplifying and modernizing the United States tax code for small businesses, startups, and entrepreneurs. Updating the tax code for the nation’s small businesses and innovators would create efficiencies and provide job creators the opportunity to focus on generating, manufacturing, and selling the newest product or service, rather than lumbering through the archaic tax code. While not exhaustive on addressing all tax issues facing small businesses, H.R. 3717 takes a step in providing equity for the nation’s small businesses.

a. Simplifying

To simplify the tax code for small businesses, H.R. 3717 contains a number of provisions that will benefit small firms, such as aligning estimated payment deadlines and tax filing thresholds. Simplification would allow a more streamlined decision making process for small businesses, thus giving them the opportunity to concentrate on creating jobs and expanding operations.

When estimated tax payments are required, the deadlines for payment are spaced in an irregular manner. Arguments have been made that inconsistent deadlines often are the cause of non-payments.¹⁴ Further, Nina Olson, the National Taxpayer Advocate, said in testimony provided to the House Small Business Committee that “taxpayers must remember oddly spaced payment dates (April 15, June 15, September 15 and January 15), which do not consistently coincide with calendar quarters, making it difficult to calculate net income and confusing taxpayers.”¹⁵ To address this, H.R. 3717 reasonably realigns estimated tax payment deadlines.

To further streamline the decision making process for small businesses, H.R. 3717 tackles the inconsistencies in reporting requirements between the Form 1099-MISC and the

¹² JOSEPH V. KENNEDY, *Three Paths to Update Labor Law for the Gig Economy 2* (2016), available at <https://itif.org/publications/2016/04/18/three-paths-update-labor-law-gig-economy>.

¹³ H.R. 3717, 115th Cong. (2017).

¹⁴ EVA ROSENBERG, *How to Pay Estimated Tax*, The Tax Blog, Marketwatch, (2011), available at <http://blogs.marketwatch.com/taxarchive/2011/03/24/how-to-pay-estimated-taxes/>.

¹⁵ *The Sharing Economy: A Taxing Experience for New Entrepreneurs: Hearing before the United States House of Representatives, H. Comm. on Small Business*, 114th Congress, Second Session (May 26, 2016) (testimony of Nina Olson).

Form 1099-K.¹⁶ While the 1099-MISC is used for services by an independent contractor and has a filing threshold of \$600,¹⁷ the 1099-K is used for payment card transactions above \$20,000.¹⁸ Beyond the variance between the filing thresholds, research indicates that companies use the forms interchangeably, often causing confusion.¹⁹ To simplify the process for small businesses, H.R. 3717 brings the filing thresholds into alignment at a value of \$1,500.

b. Modernizing

With the last comprehensive re-write of the code taking place in 1986,²⁰ many of the existing provisions are not tailored to a business that utilizes the latest technology to operate. H.R. 3717 would change this. From a provision that requires the Secretary of the Treasury to establish uniform standards and procedures for electronic signatures to a requirement for address verification for refunds, this legislation includes a number of provisions aimed at updating the code for today's modern small businesses and startups.

When small businesses build their teams by employing individuals, it is natural to contemplate the benefit packages that might be available to workers. Unfortunately, cafeteria plans, or certain pre-tax benefits such as health savings accounts or group-term life insurance,²¹ apply only to employees and not owners due to current IRS interpretation.²² To address this discrepancy, H.R. 3717 clarifies that Section 125 of the tax code allows owners to not only offer cafeteria plans, but also the ability to participate in the plans themselves.

Driven by technology changes and advancements, companies are able to provide more flexibility to their workers. This becomes apparent in companies that utilize sharing economy platforms, where independent contractors play an important role, thus making worker classification decisions extremely important. The IRS on its website describes the decision as "critical."²³ Incorrect classifications can have penalties.²⁴ This becomes further complicated when important employee/employer arrangements, such as voluntary withholding agreements,²⁵ are on the table. Currently a decision to offer an agreement will impact worker classification. Worker classification changes can also be triggered when companies offer voluntary training to its workers, such as safety courses. H.R. 3717 proposes a clarification that decisions to offer voluntary withholding agreements and voluntary training will not impact worker classifications.

¹⁶ For further information on the 1099-MISC and 1099-K forms, please review the Committee's memorandum on *The Sharing Economy: A Taxing Experience for New Entrepreneurs, Part I and Part II* (May 2016), available at https://smallbusiness.house.gov/uploadedfiles/5-24-16_hearing_memo.pdf.

¹⁷ IRS, INSTRUCTIONS FOR FORM 1099-MISC (2017), available at <https://www.irs.gov/pub/irs-pdf/i1099misc.pdf>.

¹⁸ IRS, INSTRUCTIONS FOR FORM 1099-K (2017), available at <https://www.irs.gov/pub/irs-pdf/i1099k.pdf>.

¹⁹ CAROLINE BRUCKNER, *Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy*, KOGOD SCHOOL OF BUSINESS, AMERICAN UNIVERSITY 9 (2016).

²⁰ Pub. L. No. 99-514 (1986).

²¹ IRS, FAQs for Government Entities Regarding Cafeteria Plans, available at <https://www.irs.gov/government-entities/federal-state-local-governments/faqs-for-government-entities-regarding-cafeteria-plans>.

²² For comprehensive information on cafeteria plans, please review the Committee's memorandum on *Cafeteria Plans: A Menu of Non-Options for Small Business Owners* (Mar. 2017), available at https://smallbusiness.house.gov/uploadedfiles/3-16-17_hearing_memo.pdf.

²³ IRS, INDEPENDENT CONTRACTOR (SELF-EMPLOYED) OR EMPLOYEE?, available at <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee>.

²⁴ *Supra* note 15 at 16.

²⁵ 26 C.F.R. § 3402(p).

To further update the code, H.R. 3717 contains provisions to exclude Social Security Quarters of Coverage²⁶ from self-employment income, along with certain health insurance deductions. All combined, the provisions proposed in H.R. 3717 provide a much needed update to a much outmoded tax code. Changes to simplify and modernize the code could provide economic expansion due to the vital role small businesses play in the economy.

IV. Conclusion

While the debate surrounding tax reform swirls on Capitol Hill, small businesses, entrepreneurs, and startups will be hard at work creating and selling their products and their services. With their impact on jobs and the economy, it is imperative that small businesses remain at the forefront of the tax reform conversation. Simply put, they are the job creators, they are the innovators, and they are the ingredients of economic acceleration for the country. The United States needs to have a tax code that promotes small business job growth and expansion, not small business roadblocks.

²⁶ SOCIAL SECURITY ADMINISTRATION, QUARTERS OF COVERAGE, *available at* <https://www.ssa.gov/oact/cola/QC.html>.