

Statement of Roger Harris
Before the U.S House of Representatives Committee on Small
Business
President and Chief Operating Officer
Padgett Business Services
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Good afternoon, I am Roger Harris, President and Chief Operating Office of Padgett Business Services.

For nearly fifty years Padgett Business Services has been providing accounting, income tax planning and preparation, payroll and payroll tax services to thousands of small business owners through our network of 300 offices across the United States. Our clients generally have 20 or fewer employees and are what some people would consider “mom & pop” businesses. Based on recent studies almost 90% of all firms that have employees operate in our target market. In addition to my forty plus years with Padgett I also had the honor of serving on the Internal Revenue Advisory Council for four years and was its Chair for two of those years. I believe this experience gives me a balanced approach to small business taxation – I have had the opportunity to see what works and what doesn’t work in the real world.

A wise man once said that owning your own business is about doing the one thing you love and 99 other things you MUST do but dislike. I can tell you with some certainty that for most small business owners at the top of that list is taxes and tax compliance. It is my experience that, while no one likes paying taxes, most hate the paperwork and time devoted to complying with the tax laws on an almost equal basis.

Over the years it has become clear to me that for most entrepreneurs the business checking account is the focal point for their bookkeeping. It is how they measure cash flow and profits, and to a great extent is the basis for their tax accounting as well. First working with President Bush’s Advisory Panel on Federal Tax Reform and most recently with David Kautter, Professor of Taxation and Executive Director of the Kogod Tax Center at American University, we have developed a legislative tax reform proposal – the Simplified Cash Method - that we believe would provide significant simplification, improve cash flow, encourage entrepreneurship and improve compliance for the Nation’s millions of small businesses.

In a nutshell, the proposal is as follows:

- **Qualifying taxpayers electing to use the Simplified Cash Method would be required to have a dedicated small business checking account (or accounts) associated with a single EIN.**

- **In order to take advantage of the Simplified Cash Method, all cash receipts and disbursements must pass through the dedicated account.**
- **Taxable income is based solely on amounts actually received**
- **Deductions would be allowed when made for cash disbursements for inventory, prepayments, capital assets and depreciable assets.**
- **Payments made for leasehold improvements would be deducted as cash disbursements are made. All other real property rules would be governed under current law.**
- **Banks would report annual gross cash receipts and disbursements to the IRS and IRS forms shall provide means on the tax return to reconcile any cash flows not income or a deductible disbursement.**

The Simplified Cash Method would have the advantage of making the business checking account the “books” for the small business. A tax practitioner would rely almost solely on it for preparing the tax return. The Internal Revenue would have the same information to decide on which businesses to audit or contact. The tax return would provide the flexibility for the taxpayer to explain differences between what is reported to the IRS and what is on the tax return. By comparison, today’s rules require many small businesses to separately track and compute depreciation, amortization, inventory capital expenditures and other items, strictly for tax purposes. On the flip side, the IRS receives only parts of the information necessary for selecting taxpayers for compliance actions. We believe that both sides win from this proposal.

We were pleased to find many of the same principles of our plan in Chairman Camp’s Ways and Means white paper. I believe it takes a big step toward a more simplified tax world for small business, especially the following provisions:

- **Permanent section 179 expensing, including leasehold improvements and computer software.**
- **Increasing the threshold for Cash Basis small business exception to \$10 million and simplifying its application.**

- **Coordinating the new cash-accounting rules with the uniform capitalization rules generally to exempt small businesses from the capitalization rules that require the allocation to their inventory of certain direct costs (e.g., materials and labor) associated with the production of the inventory as well as indirect costs (e.g., overhead and administrative expenses).**
- **Combining three existing provisions for start-up and organizational expenses into a single provision applicable to all businesses and increasing the threshold to \$10,000.**

It is my sincere hope that the Committee on Ways and Means will consider further simplifying the inventory rules so that most business with inventory and under the \$10 million gross receipts could benefit from additional simplification.

The white paper also provides an interesting discussion on reforming the rules governing tax structures, partnerships and S corporations. As a general rule, it is important to keep in mind that small businesses do not plan always their tax structure they simply evolve to the situation. I would like to illustrate that with a story I have told to many audiences.

When a person mows his own lawn, it's considered a hobby. If the neighbor notices he does a good job and offers to pay him to mow his lawn, he becomes a sole proprietor. When he signs up enough neighbors, he brings in a friend and they become a partnership. At that point, the two of them realize that all the tax accounting and legal issues are too complicated and they seek out help and are advised to become an LLC. Without any planning their life got much more complicated but to them they are still just cutting grass. What we should all want for these people is for their business to continue to grow so they continue to hire more people to keep up with demand. The only way for that to happen is for them to keep cutting lawns instead of keeping unnecessary records.

With this in mind, I would like to comment on the following issues in regard to option 1 of the white paper:

The proposed changes in this section are very beneficial to businesses that operate as S Corporations. For our customers this is a very common business structure and these proposed changes would be welcomed. While few of our clients operate as a partnership those that do would also welcome most of the proposals. There are some proposed changes to payments made to partners that will require some change of thinking but as a whole these too would be beneficial for our clients.

As to option 2, I think it is important to say that this represents more of a radical change from the current tax structure. As we all know, change can be a scary thing for some people. I do have some concern about the proposal to require entity level withholding on income for the smallest of small businesses. For this group, withholding on payments to the partners instead of income would be simpler for them to comply. Also, option 2 could generate more in the way of transition rule issues. But this option would still be an improvement over the current system.

In conclusion, it is important to remember that policymakers should always try to strike a balance between tax compliance and taxpayer burden. For many small business owners that rely heavily on their business checking account for their basic books what might seem like good tax policy here in the halls of Congress will, and is, seen as needless burden to someone simply trying to make the next payroll. Chairman Camp's proposal definitely heads in the right direction for entrepreneurs looking for a simpler system that simplifies their life and lets them just focus on running and building their business. Thank you for this opportunity to testify today and Padgett Business Services looks forward to working with this Committee and the Committee on Ways and Means on this crucial issue.

For additional information on the Simplified Cash Method proposal, please see the following:

David Kautter and Donald Williamson, "A Simplified Cash Method of Accounting for Small Business" **Tax Notes**, February 13, 2012, pages 863-867.

General Accountability Office "TAX GAP - A Strategy for Reducing the Gap Should Include Options for Addressing Sole Proprietor Noncompliance" July 2007 GAO-07-1014

The Report of The President's Advisory Panel on Federal Tax Reform, pages 94-96, 127-128