October 2, 2017

United States Senate
Committee on Finance
215 Dirksen Senate Office Building
Washington, D.C. 20510

RE: Hearing on Business Tax Reform

Dear Chairman Hatch, Ranking Member Wyden and fellow Members of the Committee:

As a leading representative of the 28 million small businesses in America, Small Business Majority is writing in response to the U.S. Senate Committee on Finance's request for written statements on business tax reform.

Small Business Majority was founded and is run by small business owners to ensure America's entrepreneurs are a key part of an inclusive, equitable and diverse economy. We actively engage our network of more than 55,000 small business owners in support of public policy solutions and deliver information and resources to entrepreneurs that promote small business growth.

Small businesses are not just the backbone of the American economy; they are its foundation. Indeed, small businesses represent 99% of all employer firms and account for half of our nation's jobs and economic output, and their creativity spurs innovation in all sectors of the economy.

Unfortunately, for too long, our nation's tax system has benefited the wealthiest Americans and large multinational corporations—leaving the rest of the country, particularly small business owners, to foot the bill. Small Business Majority's polling[i] has shown that 90% of small business owners believe big corporations are using loopholes to avoid taxes that small businesses have to pay, and 92% believe corporations' use of those loopholes is a problem. Similarly, 9 out of 10 small business owners believe that the fact that U.S. multinational corporations' use of these loopholes to shift U.S. profits overseas is a problem.

Our country's largest companies don't need a tax break; rather, we need a tax system that benefits America's entrepreneurs who are focused on growing their enterprises and making payroll at the end of each month. Small businesses can certainly benefit from a reduction in corporate tax rates, but only if accompanied by the elimination of costly loopholes that only benefit large corporations.

That's why we're concerned by the current proposal from Republican leadership for tax reform. While cutting the corporate rate to 20% would help some small business owners, doing so without getting rid of corporate tax loopholes would greatly increase the deficit, and continue to put small businesses at a disadvantage. What small businesses really need are reforms that will level the playing field so that they are not stuck footing the bill when large corporations take advantage of loopholes and avoid paying their fair share. Although there is not enough information about the plan yet to fully understand how much this might add to the deficit, a rough estimate from the Tax Policy Center estimates the tax proposal would have a net cost of $2.4 trillion over the next 10 years.[ii]

While some claim the Republican leadership's proposal to cap the tax rate for pass-through entities to 25% would be a boon for small business, in fact, this would impact very few small firms. Nearly 9 in 10 pass-through entities already pay 25% or less, and less than 2% of small businesses pay the current top individual rate of 39.6%.[iii] This proposal would primarily benefit hedge fund managers, lobbyists, lawyers and investment bankers—not Main Street small businesses. A recent analysis by the Urban-Brookings Tax Policy Center found that 88% of the gains generated by capping the pass-through rate to 25% would go to the top 1% of people.[iv] What's more, policies like these can encourage wealthy individuals to game the system by declaring themselves pass-through business entities.

Additionally, we oppose the proposal to move to a "territorial" system from a "worldwide" system because it would allow only a select few large multinational corporations to game the system by funneling their profits to the lowest-taxation foreign jurisdictions. The repatriation proposal fails to address the substantial tax advantage given to big businesses because it would not do away with the loophole that allows multi-national corporations to defer paying taxes on foreign profits. This loophole costs the U.S. Treasury Department more than $1 trillion over 10 years.

What's more, this proposal seems to perpetuate the myth that ending the estate tax will help small business owners. In reality, the estate tax, which only applies to estates valued above $11 million for married couples, impacts only about 50 of our nation's 28 million small businesses and small farms.[v]

If policymakers are serious about wanting to enact tax reforms that will help small business, they need to implement policies that will help all entrepreneurs—from the Main Street restaurants and independent retailers, to the consulting firm with 25 employees and the solo-entrepreneur just getting their business off the ground—rather than giving a tax break to those who need it least.

Small Business Majority Tax Reform Recommendations

In sum, any reforms to the nation's tax code must level the playing field, simplify the tax code and ensure fairness for small businesses. This includes:

- Ensuring any changes to the corporate and personal tax codes have a significant, direct benefit to small businesses and self-employed individuals, as opposed to large businesses, hedge funds and the very wealthy.
- Allow pass-through entities and C-Corp small businesses to deduct their first $25,000 of profit, thus benefiting the vast majority of small businesses from the bottom-up rather than passing current top-down proposals that will only benefit a select number of the wealthiest businesses and encourage some individuals to game the system by declaring themselves pass-through business entities. This deduction should be accompanied by a phase-out for businesses with $150,000-200,000 in income to ensure it benefits the entities most in need.
- Reducing the nominal corporate tax rate to 28%, thus reducing the actual tax rate for most C-Corp small businesses, while eliminating unfair, inefficient tax loopholes in a manner that ensures a net revenue increase to bring down our deficit and fund key programs. Likely loopholes that can be eliminated include:
    - Offshore tax deferral: This loophole costs the U.S. more than $1 trillion over 10 years and creates an unequal playing field for small businesses that are paying their fair share. It almost entirely benefits 50-60 select multinational corporations and no small businesses. Moreover, any attempt to repatriate existing offshore profits in exchange for a lower rate, without ending deferral moving forward, will only perpetuate this costly inequity.
    - Accelerated depreciation: Small businesses can already deduct up to a half a million dollars in capital expenditures under existing law – this provision should be retained. But, most small business owners don't have additional capital expenditures that enable them to benefit from the larger accelerated depreciation loophole that costs $400-600 billion over 10 years.
    - U.S. production/manufacturing credit: This credit benefits large corporate special interests and costs $190 billion over 10 years.
    - Carried interest: This loophole only benefits hedge funds by allowing them to pay taxes on ordinary income at special lower capital gains rates, costing the U.S. $20 billion over 10 years.

- Opposing any efforts to reduce top individual tax rates. It is a myth that top individual tax rates adversely harm small Main Street small businesses. The current top rate is paid by less than 2% of pass-through business owners, while only 4% pay more than 28%.
- Opposing the enactment of a "territorial" corporate tax system that would allow a select few large multinational corporations to game the system by funneling their profits to the lowest-taxation foreign jurisdictions.
- Cracking down on the ability of large corporations to reduce their tax burden simply by parking their profits offshore or moving their headquarters outside the country.
- Upholding the estate tax in its current form, understanding that it currently protects virtually all small businesses and family farms.
- Ensuring parity between online and bricks-and-mortar businesses with a reasonable and fair Internet sales tax solution.
- Simplifying and expanding the small business tax credit created by the Affordable Care Act—helping more small businesses qualify for and utilize it.
- Passing healthcare tax equity for the self-employed so that freelancers can deduct their healthcare expenses from their FICA tax obligations—just like other business entities.
- Passing the bipartisan Investing in Opportunity Act that will help revitalize economically distressed communities by, among other things, allowing investors to temporarily defer capital gains recognition in they invest in an "Opportunity Zone."
- Increasing limits for deducting start-up and organizational expenses from the current $5,000 levels.
- Allow very small firms to use a simplified method of cash accounting.
- Creating tax incentives for angel investors. More than half of states offer tax incentives for angel investors. Federal support of these efforts would encourage more local and state governments to consider such measures.

This is a rare opportunity to make our nation's tax code better for small businesses, but we must enact reforms that will truly benefit small firms instead of giving a tax break to those who need it least.

Sincerely,

John C. Arensmeyer

John Arensmeyer
Founder and CEO

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[i] http://www.smallbusinessmajority.org/our-research/taxes-budget-economy

[ii] https://www.washingtonpost.com/news/wonk/wp/2017/09/29/gop-tax-plan-would-provide-major-gains-for-richest-1-percent-and-uneven-benefits-for-the-middle-class-report-says/?deferJs=true&outputType=default-article&tid=a_breakingnews&utm_term=.62a38a740792

[iii] http://www.taxpolicycenter.org/model-estimates/distribution-business-income-august-2016/t16-0185-sources-flow-through-business

[iv] http://www.taxpolicycenter.org/model-estimates/options-taxing-pass-through-income-prefential-rates-may-2017/t17-0166-distributional

[v] http://www.taxpolicycenter.org/model-estimates/baseline-estate-tax-tables-nov-2016/t16-0277-current-law-distribution-gross-estate