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ROUNDTABLE DISCUSSION ON TACKLING TAX COMPLEXITY: THE SMALL BUSINESS PERSPECTIVE

JOINT HEARING

BEFORE THE

COMMITTEE ON FINANCE

AND THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

UNITED STATES SENATE

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JUNE 7, 2023



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ROUNDTABLE DISCUSSION ON TACKLING TAX COMPLEXITY: THE SMALL BUSINESS PERSPECTIVE

WEDNESDAY, JUNE 7, 2023

U.S. SENATE,
COMMITTEE ON FINANCE,
COMMITTEE ON SMALL BUSINESS
AND ENTREPRENEURSHIP,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:03 a.m., in Room SH–216, Hart Senate Office Building, Hon. Ron Wyden (chairman of the Committee on Finance) presiding.

Present: Senators Hirono, Crapo, Young, Johnson, Tillis, and Risch.

Also present: Senate Committee on Finance Democratic staff: Ryan Carey, Chief Communications Advisor for Tax, Investigations, and Oversight, Spokesperson; Ursula Clausing, Tax Policy Analyst; Sarah Schaefer, Chief Tax Advisor; and Tiffany Smith, Deputy Staff Director and Chief Counsel. Republican staff: Amanda Critchfield, Communications Director; Jamie Cummins, Senior Tax Counsel; Eric Fejer, Deputy Press Secretary; Kate Lindsay, Tax Policy Advisor; and Gregg Richard, Staff Director.

Senate Committee on Small Business and Entrepreneurship Democratic staff: Sean Moore, Staff Director; Shivani Pampati, Tax and Economic Policy Advisor; and Steve Chang, Legislative Assistant. Republican staff: Meredith West, Staff Director; Daniel Noonan, Research Assistant; Jessica Helmers, General Counsel for Senator Young; and Burke Miller, Legislative Assistant for Senator Young.

OPENING STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON, CHAIRMAN, COMMITTEE ON FINANCE

Chairman WYDEN. The two committees will come to order. Let me welcome everyone to this morning's roundtable, jointly hosted by the Finance and Small Business and Entrepreneurship Committees. I also particularly want to recognize Chairman Cardin. He has been an extraordinary member of the Senate Finance Committee. He tells me I should give up efforts to talk him out of retirement.

I will tell you, it was his idea to bring together our two committees and discuss how small businesses could benefit from smart improvements to the Federal tax system. So, we want to begin with big improvements to IRS customer services.

One of the key goals of the Inflation Reduction Act was improving customer service at the IRS. That had been clobbered over the years by a decade of Republican budget cuts. The investment is already paying significant returns. The phone call response rate went from 10 or 15 percent over the last few years, up to almost 90 percent in the most recent filing season.

Wait times dropped to just a few minutes. IRS staff worked through the entire backlog of error-free individual returns, which includes returns from small businesses that are structured as pass-throughs. The IRS is taking important steps to prevent future backlogs and make it easier for taxpayers to resolve issues online.

Now, taken together, these improvements should help to prevent a lot of headaches for our small businesses, and particularly reduce the audit rate for small business owners. Audit rates—and reducing them for small business owners—are something Senator Crapo and I have talked often about. A fully funded IRS also helps prevent tax scams, and I expect we will hear more about that today.

I have also felt strongly about regulating tax preparers to root out scammers making money off honest small businesses, and Senator Cardin has been our leader on the Finance Committee, trying to speed up the goal of improving preparers.

Unfortunately, Republicans have wanted to repeal the funding that has made these improvements possible. Just last week, Speaker McCarthy made clear that the $20-billion IRS funding cut in the default agreement is not enough. He wants to eliminate all of it. That would be a major setback for small business taxpayers, who deserve a functional IRS.

Second issue: Democrats want to make sure that small businesses and typical American families get a fair shake with any tax changes. Republicans want to lock in tax breaks for businesses. That includes the pass-through deduction that moved as part of the 2017 Trump tax law, a provision where the claim was that it was designed to benefit small businesses.

The nonpartisan Joint Committee on Taxation did the math, and the reality is most of the benefits of the pass-through deduction are going to people at the top. In 2019, fully half of the benefits went to individuals who earned $820,000 or more. That is less than 1 percent of the Nation.

Nobody, nobody wants to penalize success. Yet, when the American people hear that Congress is debating tax cuts for small businesses, I do not think they envision huge benefits going to real estate moguls or Wall Street investment firms.

So it is my view that Congress ought to do a better job of targeting tax cuts to the real small businesses that drive the Oregon economy and economies from coast to coast. Local shops, restaurants, garages, small manufacturers would be some examples.

Finally, I expect the tax incentive for research and development to be a significant part of today's discussion. That incentive—and let me emphasize—has my very strong support. It has support on both sides, and everybody knew that full expensing for research and development was set to expire at the end of last year.

With the expiration date approaching, Democrats told Republicans we would support extending it, as long as Congress also passed tax cuts for working families. That had been the bipartisan

approach—let me underline that—the bipartisan approach on dealing with expiring tax provisions for many years. It also is a good deal for a lot of small business owners who benefit from both research and development expensing and the Child Tax Credit. Republicans, however, refused to negotiate any agreement that involved the CTC. It is my hope that Congress is able to break the logjam on these issues in order to help families and small businesses get ahead.

So, there is much to talk about this morning. I want to thank all of our participants. There is a lot of bipartisan willingness to come together on these issues. I think you will hear that this morning, and let us go next to Senator Cardin, and then we will have Senator Crapo and Senator Young.

Senator Cardin?

[The prepared statement of Chairman Wyden appears in the appendix.]

OPENING STATEMENT OF HON. BENJAMIN L. CARDIN, A U.S. SENATOR FROM MARYLAND, CHAIRMAN, COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

Chairman CARDIN. Well, Chairman Wyden, first, thank you very much for cohosting and agreeing to this roundtable discussion on the tax complexities, the small business perspective. I think all of us recognize the importance of small businesses, and I think this is an extremely important opportunity.

I want to thank Senator Crapo for his help in arranging for this hearing. I also want to thank Senator Young, who is a valuable member of these committees, but he is also taking on Senator Ernst's responsibility today, since she could not be here. So, I want to thank Senator Young.

The Small Business and Entrepreneurship Committee works in a bipartisan way. And we recognize that, as advocates for small business, we need to find the sweet spot in order to help our small businesses. Small businesses are the growth engine of our Nation's economy. We know that. That is where jobs are created. That is where innovation takes place.

But we also recognize that they do not have a team of accountants and tax lawyers that can handle the challenges of our tax code. And so, often they miss out on benefits that they would otherwise be entitled to, or fall out of compliance of the tax code because they just do not know about the changes that are being made, or the expiration of a tax provision, or the way that we decide to expand a tax provision.

So, the small business tax literacy issue is a real issue, and we have to figure out how we can make our tax code and the resources available to small businesses friendlier, so that they can comply with the tax law, take advantage of the tax law, and that our tax law is fair to small companies versus the larger companies.

So, let me go over some of the challenges that small businesses have told me about. First, the complexity of the tax code. It is difficult for a small business owner to understand the tax code, and we have surveys that show that the overwhelming majority cannot figure out the tax code in dealing with their businesses.

We have eligibility. There are different eligibilities for different provisions. I want to thank the Joint Committee on Taxation for their report, but if you will take a look on pages 50 through 71, they give examples of different definitions used for different provisions for small businesses that are entitled to it. How can a small business be able to get through all that?

The planning process: when you have expiration of tax provisions, it is so difficult for a small business owner to be able to plan his or her future. The fairness of our tax code for small business owners and sole proprietors and pass-through entity businesses that use the individual tax code and rates, versus the C corporations, which are our larger corporations—there is an issue of fairness there.

And then there is the effectiveness of the business tax provisions for small businesses, and I know we are going to hear a lot about individual provisions in our tax code and compliance as to the burdens or help they provide for small businesses.

We will hear about 1099–K reporting; the pass-through provisions that were enacted in the 2017 tax bill; section 179 expensing; start-up expensing; R&D changes that the chairman already mentioned. I can tell you this: the IRS-determined small companies are struggling in regards to the R&D restrictions that are currently in law.

The last one I just want to bring up is the effectiveness of the services that we provide today. The IRS does provide services for small businesses. They have publications. How effective are those publications? We have the Taxpayer Advocate Service. How effective are their services?

And we have the pilot program for Direct File. Is that helping? Is that the future or—as we hear from some who oppose that—is that just not going to be a feasible way to deal with those challenges?

Within the Small Business Administration, we have many tools that are available, including the Money Smart for Small Business curriculum that was created with the FDIC. How effective is that then in helping small businesses?

We have our resource partners, the SBDCs, the Women's Business Centers, the VBOCs, the SCORE, the STEP. How effective have those programs been in helping small businesses get through the challenges in our tax code?

And then lastly, the underserved communities. The small business tax literacy is more challenging in underserved communities. The tools of the MBDA, are they effective at helping the minority communities in dealing with these issues?

So, there is a lot to talk about, and that is why I wanted to welcome our panelists today, to try to help us in this discussion as to how we can use the current tools that are available, the current provisions in our tax code, and where we need to put resources or changes in those codes to help our small businesses continue to be the growth engine of our economy.

Thank you, Mr. Chairman.

Chairman WYDEN. Thank you, Mr. Chairman.

Let us go to now Senator Crapo and Senator Young.

Senator Crapo?

OPENING STATEMENT OF HON. MIKE CRAPO, A U.S. SENATOR FROM IDAHO

Senator CRAPO. Thank you, Mr. Chairman. Before I give my formal statement, I do just need to respond quickly, because the issue of taxes has come up—and tax policy—and that is one area where we have some differences of opinion.

I will just say with regard to the IRS, I am glad they are starting to answer the telephone, and there was never any objection on the Republican side to the adequate funding for the IRS to be able to have the employees necessary and the technology necessary to be in the 21st century and answer the phone, and to help taxpayers deal with the complex tax code that we have.

That $80-billion IRS slug of money that we are fighting over did allocate money for that. But less than $10 billion of that $80 billion was for those purposes. The other $70 billion, actually about $50 billion of the other $70 billion, went to increased auditing.

And if you do not think that means more audits for small businesses, I just—I do not see how that can be denied. That being the case, the other issue that was brought up that I want to focus on just quickly before I give my full opening statement is the 20-percent pass-through that small businesses got under the 2017 tax act.

That is going to expire in a few years, as everyone knows, and if it matters to you, I hope you say so today, because there is a debate going on here in Congress right now as to whether or not that 20-percent pass-through provision is helpful to the small businesses in our country.

So, I would just encourage you to maybe add that to your statement. Whatever side of that you are on, we need to hear that, because we are making those tax policy decisions today.

Now quickly to my opening statement. A big "thank you" to both of our chairmen for putting this hearing together. It is critical. I have a big "thank you" for Ms. Camarillo, who flew in from Idaho to join us today. Stephanie and I go back a long way. She actually served as a Senate page for me when I was in the Idaho State Senate. She has been doing great things for Idaho ever since. She has had a big impact on the small business landscape in Idaho, and I am eager to hear her perspective today.

Small businesses drive our economy and are particularly essential to Idaho's economy. More than 99 percent of Idaho's businesses are small businesses, employing over 347,000 Idahoans and spurring local innovation. Unfortunately, despite all that small businesses do for America's economy, the Federal Government does not always return the favor in kind.

Too often, the impact on small businesses is not properly evaluated before misguided government policies are enacted. The financial burden of increased taxes and compliance costs resulting from a complicated tax system and regulatory environment make it hard for small businesses to make sound financial decisions.

When coupled with uncertainty about future tax policy changes and the Internal Revenue Service enforcement, those decisions become nearly impossible. According to the latest National Federation of Independent Business annual tax survey, nearly two-thirds

of small business owners reported that the administrative burden of the Federal tax code is significant.

Further, 90 percent of small business respondents hired an outside tax professional to prepare and submit their returns. Compliance and complexity were determined to be the leading factors in a small business's decision to hire a tax professional.

While the amount due is not the only tax concern, American small businesses and workers continue to face elevated inflation as well as workforce and supply chain challenges. Therefore, it is critical that our tax system promotes U.S. jobs, U.S. manufacturing, and higher wages for hardworking families.

Pro-growth policies in the Republicans' 2017 tax law led to one of the strongest economies in decades, low unemployment, a low poverty rate, strong wage growth, high median incomes, increased investment, and record tax revenues. I want to repeat that: record tax revenues.

To give small businesses certainty and incentives to grow and compete in the domestic and international economies, we should preserve these policies and explore additional opportunities to promote growth, increase investment, and encourage research and development in the United States.

We need to get the government out of the way of the small business engine of our economy. Removing the disincentive of complex and high taxes and costly regulations will allow small businesses to go out and do what they do best: create jobs and growth in our economy by providing valuable goods and services to their customers.

Thank you to all of the witnesses participating. I look forward to hearing from you.

[The prepared statement of Senator Crapo appears in the appendix.]

Chairman WYDEN. Thank you, Senator Crapo. And I want my friend to know that his kind words about Ms. Camarillo do not mean he forfeits the right to have a more full-fledged introduction as we go later on.

Senator Young?

OPENING STATEMENT OF HON. TODD YOUNG, A U.S. SENATOR FROM INDIANA

Senator YOUNG. Thank you, Mr. Chairman. I want to thank both of the chairmen for holding this important hearing, and I want to thank our witnesses for taking time out of your very busy schedules to be here today to offer your thoughts on how we can improve our tax system.

And a special thanks to Mike Norris of Warrant Technologies, Bloomington, IN. You and your team are doing amazing work to support our warfighters, and yours is the sort of dynamic, innovative small business we need to cultivate and encourage through our tax system and other means.

It is really imperative that we continue to evaluate how our tax system impacts small businesses, so that we make sure we are facilitating growth, while cutting down on unnecessary complexity in our tax code. In my lifetime, all net new job creation in this country has occurred through the creation of new firms and young

firms, traversing that proverbial Valley of Death, and they are often operating on very thin margins.

So we need to be sensitive to that as we hear testimony from our witnesses, and use that to inform our tax policy. I think from my standpoint, the reason for today's roundtable is quite simple: start-ups and small businesses not only drive growth, they also drive innovation. We cannot expect to have a dynamic economy if we do not support our small businesses and their role in developing new products and new technologies.

Unfortunately however, our innovative small businesses are facing crushing tax liabilities as a result of the expiration of full and immediate expensing for research and development expenditures under section 174 of our tax code.

Starting in 2022, businesses are now required to amortize their R&D investments over 5 years. While this change impacts businesses of all sizes, it is particularly harmful to small businesses, who cannot readily absorb the sudden, and in many cases unexpected, increased tax liability.

Amortization dramatically decreases small businesses' cash on hand, and it diminishes the amount of capital they are able to invest in R&D in future years. I have personally heard from countless Hoosier small businesses that are being forced to make some very difficult choices, such as cancelling planned expansions or even laying off workers as a result of the tax hit from R&D amortization.

The shift to amortization comes at a time when our foreign competitors, namely China, are continuing to increase their R&D incentives and invest in the development of critical technologies. China already offers a so-called super-deduction for research and development investments. If a company invested $100 in R&D in the United States in 2022, they got to deduct $10 for that year; $100 investment, $10 deduction in the United States.

If that company invested $100 in China, they would be able to deduct $200—$200—20 times as much their incurred benefit as they would receive in the United States. And yet just last week, it was reported that China is considering additional tax incentives to encourage manufacturing companies to increase innovation in an effort to counter the United States.

We cannot sit idly by—as a matter of economic growth, as a matter of national security—and allow our competitors to surpass our great Nation in the development of critical products and technologies. To address this issue, Senator Hassan and I introduced our American Innovation and Jobs Act earlier this year.

This bipartisan bill—it is broadly bipartisan—would restore section 174 full and immediate expensing, thereby incentivizing small businesses to continue to invest in R&D and propel the U.S. economy forward. I want to thank everyone here who has supported and advocated for this legislation.

Time is of the essence, as we will hear today. Our small businesses are struggling. It is critical that we pass my American Innovation and Jobs Act this year—this year—to ensure we continue to out-compete and out-innovate our international rivals.

Thank you, Mr. Chairman.

Chairman WYDEN. I thank my colleague. He has made a number of important points. And to our guests, you have four members of the Senate Finance Committee who have jurisdiction over this extraordinarily important research and development tax credit issue. Our committee has a history of working on big issues in a bipartisan way.

We understand the urgency here. I believe we can get a balanced package this year that includes the area that my colleague just mentioned, and also provides the opportunity for additional legislation that gives all Americans the chance to get ahead. As chairman of the committee, I am committed to working with Senator Crapo and all our colleagues to get that done.

We are going to introduce our guests now. Our first guest is Alicia Chapman, and she is an Oregonian, and she is the CEO of Willamette Technical Fabricators. In addition to leading her small business, she is somebody who has spent a long time thinking about how government and the private sector can work together.

Before starting her business, she led research for Boeing and industry partners for the Oregon Manufacturing Innovation Center. Prior to that role, she worked at the Institute for Sustainable Solutions, and she was recently appointed by the Governor to be on the Commission for Women and the Oregon Transportation Commission.

I just want to tell a brief story about Ms. Chapman, because I visited her company recently. It was a cold day this winter, and I visited with the workers, to kind of have a little sort of coffee hour that all my colleagues know about.

And so, I talked to a few, and one of them in the front raised his hand, and he said if it was not for Ms. Chapman, he would not have had the opportunity to start a new life coming out of prison. That was his comment. He said because of Ms. Chapman and this small business, he was having a chance to own a home, provide for his family, to get ahead.

He pointed at Ms. Chapman, and he said, "Without her, that opportunity would not have been available to me," and we all know the challenge so many face coming out of prison, getting a family-wage job and being able to advance themselves. So, you can talk about small business in the abstract; you can talk about helping your community in the abstract. You are looking at Exhibit A for my home State of somebody stepping up and making a big difference.

So, we are very appreciative.

Let me turn it over to Chair Cardin to introduce our next guest. And then in vintage Senate process, Senator Crapo will give a formal introduction to Ms. Camarillo; Senator Young will introduce Mike Norris; and then I guess I am supposed to swing into action to introduce you, Mr. Harris, because, apparently, you do not have a colleague on the committee. So we are going to give you a good send-off.

Senator Cardin?

Chairman CARDIN. Mr. Harris, I just want you to know, I feel the same way about the people of the District of Columbia. They do not have their representatives here. So I have sort of adopted all the

people from the District, so welcome. It is nice to have you here, Mr. Harris.

It is my real pleasure to introduce Avonette Blanding. She is a financial leader in the State of Maryland, and we appreciate everything she has done for the State of Maryland. She is the managing member and owner of Blanding Financial Solutions, a business management consulting firm that aims to positively impact the quality of life of small business owners by strengthening their financial literacy to increase access to capital.

She is an account subject matter expert with over 30 years of experience, and she has used that expertise as an instructor for Morgan State University's Baltimore Means Business entrepreneur growth program. I say that because Morgan is one of the great HBCUs in our State and Nation, and her work has expanded opportunities to the traditionally underserved communities, the minority communities.

I say that because 2021 was a record year. Mr. Chairman, we should be very proud of the number of small business startups in 2021; it was a record year. It was led by women and led by women of color. I know that the work that Ms. Blanding has done in Baltimore at Morgan has really contributed to those efforts. So I want to welcome her here today—and thank you for your service.

Chairman WYDEN. I thank my colleague.

Let us go to Senator Crapo for another introduction for Ms. Camarillo.

Senator CRAPO. Thank you, Mr. Chairman. I appreciate the opportunity to say more about Stephanie. Stephanie Camarillo is the owner of Molly Maid of Boise and the Treasure Valley, a residential cleaning franchise.

Fifteen years ago, Ms. Camarillo became an entrepreneur when she purchased Molly Maid of Boise and the Treasure Valley with her husband Enrique. Ms. Camarillo has prioritized financial education, helping employees learn how to make wise investment decisions for their family's future.

Molly Maid currently employs 42 people and has received numerous awards, including multiple years as the top woman-owned business from the *Idaho Business Review,* and was voted as the city's best cleaning service.

She serves on the leadership council for the National Federation of Independent Business, and as Idaho's immediate past president for the Entrepreneurs Organization, where she has also held both regional and global roles.

Again, Stephanie, I am pleased that you have joined us today, and I look forward to your testimony.

Chairman WYDEN. Senator Young?

Senator YOUNG. Well, I alluded to it earlier, but today I have the distinct pleasure of introducing Mr. Mike Norris. He is a Hoosier in the world of systems engineering and program management. He is president and CEO of Warrant Technologies in Bloomington, IN.

Mike oversees a team of more than 50 employees serving DoD and the State of Indiana in logistics software engineering and Naval education training. Prior to this, he served in the United States Navy for 21 years, achieving the rank of Operations Specialist Master Chief. They do not give those away. Over the years,

Mike has carved a path for himself in the tech industry, with leadership roles at NOVONIX corporation and Tristar Engineering, before taking the helm at Warrant.

He holds several degrees: a bachelors in business administration with technology management; and two separate master's degrees: one in organizational management, the other in software engineering.

I want to thank Mike for participating in today's roundtable and serving as an example here in Washington of Hoosier ingenuity, integrity, and grit.

Thank you, Mr. Chairman.

Chairman WYDEN. Integrity and grit. It sounds like a law firm, attorneys at law. All right.

Mr. Harris, we are glad you are here. Mr. Harris runs Padgett Business Services, which is a national accounting advisory and tax prep company with almost 200 offices around the United States.

So, throughout his career, he has been engaged in advocating for common-sense policies for small businesses. He was on the IRS Advisory Council. He was Chair for 2002 and 2003, and he is active in the National Association of Enrolled Agents, is entitled to practice before the IRS, and is an accredited tax advisor.

So, we are very glad that you are here. We have a good panel. Let us go forward in appropriate Oregon fashion, starting with Ms. Chapman, whom I have visited at her company, and you heard my remarks. We are glad you are here.

STATEMENT OF ALICIA CHAPMAN, OWNER AND CEO, WILLAMETTE TECHNICAL FABRICATORS, PORTLAND, OR

Ms. CHAPMAN. Thank you. Thank you, Chair Wyden. Thank you, Chair Cardin and members of the committees. For the record, my name is Alicia Chapman. I am the owner and CEO of Willamette Technical Fabricators headquartered in Portland, OR. We are a custom complex metal manufacturing company focused on transportation and clean energy infrastructure, including bridges and hydropower dams.

We are also a certified economically disadvantaged women- and minority-owned business by the SBA and in our home States of Oregon and Washington. Since I founded the company in 2020, we have grown rapidly and provided high-skill, high-demand, family-wage jobs to 42 employees. We have avoided layoffs through the pandemic and the more recent recession concerns.

But in spite of our successes, right now we are honestly at a crossroads, and that is in large part due to excessive delays from the IRS. I will give some examples. My company has conducted substantial R&D, research and development, through our startup years. We were recently awarded an SBIR grant from the Department of Energy to develop proprietary robotic welding technology. This is going to help make our country more competitive, resilient, and energy-independent. Unfortunately, we have been unable to finalize our 2022 tax returns, and we were forced to file for an extension because of delayed guidance from the IRS on capitalization and amortization of section 174, as Mr. Young described.

We were already struggling with the updated provisions that require us to amortize these expenses over multiple years, especially

compared to our competitors, which are primarily in China, and the substantial benefits that they are receiving from their own government.

But while we anxiously await the passage of legislation that will address this gap, it is holding up hundreds of thousands of dollars in refunds that we need to continue to invest in innovation and our workforce. In addition to the R&D tax credits, my business qualified for over $125,000 in Employee Retention Credits or ERCs, for maintaining and expanding our workforce through the pandemic.

We have been waiting on that payroll tax refund for over 8 months now, and I am also personally waiting on a tax refund of over $20,000 from the IRS, which I fully intend to reinvest in my business. Because of an AI-generated response, I was able to use the CARES Act to take out a loan against my 401(K) to have start-up capital to invest in my business, and I received a very unexpected bill from the IRS 2 years later. They had provided an erroneous correction to my refund that charged me over 10 percent of the penalties plus interest of this early deduction that I had taken against my 401(K), which the CARES Act 2022 provision specifically waived.

So again, I am waiting over 8 months for hundreds of thousands of dollars in refunds from the IRS for my business and for me personally. I have been trying to reach a person at the IRS. I am encouraged to hear that the automatic response that I typically get that the system is so overloaded I cannot even be put on hold, that those are being addressed. I have not had such luck, but I will continue to try. And when I actually do get through to a person, I get nothing but apologies, that they are overloaded, that they are short-staffed, and they wish they could help me but they simply cannot respond directly.

So, these long wait times have forced my business to pay double what we have budgeted in outside CPA and accounting firm assistance, both to file our taxes and to continue to follow up on these overdue refunds. While we wait for these refunds, we are essentially financing the Federal Government at record-high interest rates, and we have had to borrow against the refunds that we have been waiting on, which is, I estimate, the equivalent of a full-time engineer for my small business.

So, I appreciate the urgent need for reform and for funding the IRS so that the people who are most qualified to actually address these concerns can get back to me.

[The prepared statement of Ms. Chapman appears in the appendix.]

Chairman WYDEN. Thank you.

Ms. Blanding?

STATEMENT OF AVONETTE BLANDING, CPA, MBA, OWNER, BLANDING FINANCIAL SOLUTIONS, LLC, BALTIMORE, MD

Ms. BLANDING. Good morning, Chairman Cardin, Chairman Wyden, and members of the committees. I appreciate the opportunity to speak to you all for the record. My name is Avonette Blanding, and I am a CPA from Maryland, as Senator Cardin said. For the past 2½ years I have been supporting the BMB program of Morgan State University.

In that role, I get the opportunity to engage other subject matter experts on accounting, tax, and technology, and present a panel discussion for small business owners and entrepreneurs, so that they can ask questions to these experts. Quite often at that panel discussion, most of the questions are regarding taxes.

The small business owners that I am working with, many of them are very small. They are just starting their businesses or have been in business for 2 or 3 years. They do not have a large amount of revenue, but they have aspirations for growing their businesses. The challenges that they face often are the complexity of the tax code, understanding the tax code, not knowing about tax incentives that their businesses may be eligible for, and finding trust partners.

The reality is that there are not a whole lot of CPAs who look like me in our communities. There are approximately 2 percent Black CPAs in the United States. However, there are a much larger number of minority business owners in the United States. So quite often, finding a partner that can connect with, that you can trust, that can understand your business, understand your cultural environment, and be appreciative of those differences, and work towards helping you to grow your business, can be a challenge.

So, I applaud you all in wanting to work together in a bipartisan way to find ways to improve tax policies that can benefit all businesses. Hopefully, it will increase benefits for minority-owned businesses, and the IRS can work with HBCUs and minority-serving institutions to hopefully provide resources that can support those small business owners in those programs, possibly sponsoring webinars or in-person information sessions where business owners can actually ask an IRS agent questions specifically related to their business.

I, like Ms. Chapman, have called the IRS. And I have been on hold, and then it hangs up on you, after being on hold for about an hour. That is not a pleasant experience. In addition to the tax literacy and finding ways for the IRS to provide services that can help business owners improve their tax literacy, I think if they can offer some type of small business-focused question-and-answer session or some type of chat option on the website—if you cannot get in touch with an actual agent, maybe a chat option on the website specifically for small business owners can help to reduce some of those questions.

I also think that having pamphlets that address specific industries, related to small businesses and the taxes just for those industries, could help to improve some of that literacy as well.

Thank you. I appreciate this opportunity, and I look forward to your questions.

[The prepared statement of Ms. Blanding appears in the appendix.]

Chairman WYDEN. Thank you very much, Ms. Blanding, and your suggestions are very good. And one I would add to it—you probably have already seen the news reports about the fact that the IRS has told us that they have found a discriminatory pattern with respect to audits of Black Americans. That is wholly unacceptable, and we are going to be pushing them very, very hard to change it.

It may be due to algorithms; it may be due to a variety of considerations. What we know is, it is totally unacceptable. We are going to be working with you and others to get it fixed.

Ms. BLANDING. We appreciate that.

Chairman WYDEN. Great.

Ms. Camarillo?

STATEMENT OF STEPHANIE CAMARILLO, OWNER, MOLLY MAID OF BOISE AND THE TREASURE VALLEY, ON BEHALF OF NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, DC

Ms. CAMARILLO. Thank you, Senate committee members, for this opportunity to be here. Thank you, Senator Crapo, as well. I also want to recognize Senator Ron Johnson, who I understand was instrumental in creating section 199A, which I am going to speak to here.

So, my name is Stephanie Camarillo, and I have owned a residential cleaning business in Boise, ID for about 15 years. The small business deduction in section 199A has had a significant impact on my business. Many of our 42 employees—we share the same number of employees—are single moms.

Some are from immigrant families. They are hardworking individuals, and it is easy to see how maybe working at a cleaning company is sort of a dead-end job. But my small business has had a unique opportunity to impact the lives of our workforce and their families. It is what makes mine and other small businesses like it unique and a vital part of our economy.

We have learned that one of the most impactful and powerful ways to grow our company and to retain the best talent is to invest in our people. We noticed, for example, that our employees were working hard, but they were not getting ahead. When we dug under the surface a little bit, it was that while they were intelligent, they were not financially literate.

So you know, we set our minds on bringing in experts to help them understand credit card debt, how to manage their finances, how to create an emergency fund—and it worked. Now close to half of our employees—and these are house cleaners—actually own their own homes. In 2018, the small business deduction allowed us to make a specific impact on an individual named Jasmine.

Jasmine is a single mom. She has worked for us for about 6 years. She started as a house cleaner, and then she would go home at night to take care of her beautiful son and to also work on her GED, which she did end up getting. Because of the tax savings, we were able to use that money directly to promote Jasmine, and now she is part of our management team. Not only that, she keeps spreading her wings, and I am confident we will be promoting her again soon.

But small businesses do not have the same access to resources as large companies do. We were challenged recently when Amazon opened a big facility just a couple of miles from our office. We lost employees due to Amazon's high wages and big signing bonuses. Wouldn't you know it though, several years later now, Amazon has been scaling back that facility, but our small business still remains,

and those investments in our workforce have actually resulted in over 10 percent of an increase in our employee numbers.

I am not a tax expert, but I want to conclude by saying that that small business deduction has had a great impact. Unless Congress acts, millions of small businesses like mine are going to face substantial tax increases in a few short years. I urge you to make this deduction permanent.

Thank you so much.

[The prepared statement of Ms. Camarillo appears in the appendix.]

Chairman WYDEN. Thank you very much.

Mr. Norris?

STATEMENT OF MICHAEL NORRIS, PRESIDENT AND CEO, WARRANT TECHNOLOGIES, LLC, BLOOMINGTON, IN

Mr. NORRIS. I would like to begin by thanking the committee for the opportunity to speak today on behalf of Warrant Technologies and other small businesses. Warrant Technologies is a veteran-owned small business focused on system and software engineering founded in 2013, headquartered in Bloomington, IN.

We have three owning partners. We have employees in seven States, totaling over 50 system software engineers, logisticians, and structural designers. We are CMMI software development level 3-accredited, we are CMMC-compliant, SPRS score of 110, hold a top-secret facility clearance, DCAA-approved accounting system, and we have made use of code sections 174 and 41 expenses and credits from 2018 through 2022.

Warrant is a partner of our DoD customers and a provider and supporter of our men and women in uniform. We are proud to play an active role in our Nation's defense. We are considered a successful small business, growing from one employee to a company of 50 employees and projected to continue that trend.

Small businesses reinvest their dollars on improvements in processes and tools; product development; developing technologies; improving infrastructure; attaining compliance with required standards; marketing; hiring corporate leaders and managers, such as HR officers, operations officers, information officers, and so on—all as an indirect cost captured under overhead, G&A, or R&D. With the dollars we reinvested as a small business, in 2022 we improved our business in the following ways. We employed 11 interns in 2022; competed for other work opportunities; hired legal, financial, and tax consultants; sent six people through advanced training; bought operational tools, furniture, software; leased office space; paid utilities, insurance benefits; and brought on two key critical corporate officer positions to help manage our growth.

You may think, well, those are just costs of doing business, and you would be right. Each of these costs are a critical part of doing business, and they contribute to our economy. At this point in our life cycle, I conservatively estimate Warrant needs to find an additional $500,000 this year to meet our critical costs of doing business.

To effectively manage our growth, we project we need this year to complete our CMC accreditation. This is the cyber-compliance with NIST 800, a government mandate, and for good reason. But

its cost is absorbed by the small business. Estimated cost: $50,000 conservatively; probably more accurately $150,000. CMMI accreditation: this is a software-developed government NAVSEA-endorsed standard, which gives evidence of a business's ability to meet DoD software design and development needs. Estimated cost: $75,000 to $150,000.

Corporate office: additional corporate officers required. We need a contracts officer. We need a Human Resources officer. We need a financial analyst; we need a receptionist; we need a recruiter. Estimated cost: $400,000. We need to train our people on the new tools and equipment, estimated cost: $80,000.

With the dollars we reinvested as a small business in the past, we conducted R&D of new technologies and product development, one recognized by NASA as a new technology. We purchased lab equipment, improved processors and infrastructure. All of this resulted in the creation of a new company, Thinker Labs.

As of December 31, 2021, expensing of R&D cost under section 175, R&D credits under section 41, and the 20-percent passthrough are no longer permitted. These must now be amortized over 5 years. An example of the impact on a small business with a net income of $2.5 million in the 21-percent tax bracket is, in the first year of the annual tax burden, it goes from $315,000 to $504,000, an increase of 38 percent. This $189,000 difference represents a high-risk, high-impact scenario for any small business.

An error in this case would mean getting a bill some years later for upwards of $189,000 in back taxes, interest, and penalties. That is just for the first year. If these tax changes persist, the impact on small businesses like Warrant Technologies could be devastating. As a small business, I project our ability to do the following is severely diminished or altogether lost.

We will be unable to meet our growth needs. We will be unable to invest in R&D and product development. Out year audits, risk about your audits, will result in small businesses finding their expenses disallowed, owing penalties and payback of expenses not amortized. This will result in the demise of small businesses.

I know this committee recognizes the value of our small businesses and the role they play in our Nation and local economies, our Nation's defense, and our ability to continue to outpace our adversaries in technological development. The involvement of small businesses in R&D efforts should be incentivized and rewarded through programs like Small Business Innovation Research, Small Business Technology Transfer, and legislation like the Small Business Innovation Voucher Act, S. 1739.

Fixing the tax burdens that start this year is in the interest of every small business, our Nation's economic growth, and the ability of our small businesses to continue to thrive and pursue research and development efforts. Adoption of the American Innovation and Jobs Act, S. 866, repeals these changes and incentivizes small business growth and participation in R&D.

I thank the Finance Committee and the Small Business Committee for the willingness to hear Warrant's statement and act on behalf of the interests of small business. In particular, I thank Senator Young for his active leadership and support of the American

Innovation and Jobs Act, and his unwavering support of Indiana small businesses.

[The prepared statement of Mr. Norris appears in the appendix.]

Chairman WYDEN. Thank you very much.

Mr. Harris?

STATEMENT OF ROGER HARRIS, PRESIDENT, PADGETT BUSINESS SERVICES, ATHENS, GA

Mr. HARRIS. Thank you, Chairman Wyden, Ranking Member Crapo, Chairman Cardin, and Senators Young and Johnson, for holding this panel today and allowing me to be here. As mentioned, I am president of a company called Padgett Business Services.

Padgett is approaching its 60th year in business, and the customers we target are businesses with fewer than 20 employees. Now, a lot of people look at that business and say, "How important is that one individual small business?" But collectively, they make up a huge part of our economy, and they are critically important, and many call them the backbone of our economy.

So, we believe you take a risk if you ignore the importance of these small businesses. When asked to describe the small businesses, I think our panelists here are a great reflection of this. The people who get into business at this level, I tell you, they get into it for one thing that they love in exchange for 99 things that they hate.

At the top of those things that they hate are the complexity and the dealings of the tax system. So, anything we can do to make their lives better and let them focus on what they really are in business to do, we will all benefit greatly from that.

It was mentioned that I served on the Internal Revenue Service Advisory Council, and I continue to meet regularly with the Internal Revenue Service. So I have had the ability to see our system both from the inside and the outside—what works well, what does not work well—and I look forward to sharing those thoughts with you as well.

Our written testimony focuses on three areas, all of which I think can benefit the small business community greatly. Number one is the role the Small Business Administration currently plays, and what it could do better. We take a hard look at our profession, the tax professionals.

As mentioned, small business relies on us almost daily for their questions and answers. You heard some of the comments today, and yet we are not all performing equally. And at times, with our responsibility, I think it is not unreasonable to think that there needs to be some minimum standards that we all adhere to, because we really do need to make sure that we are all doing our job if we are going to be the primary advisor to the small business community.

Lastly is the overall complexity of our tax code, and how the IRS deals with it. And I think we have the opportunity, coming out of the pandemic, to reflect back on how well some things were done, how badly other things were done. We need to learn from our mistakes. I think we are all sitting here and suffering potentially from a very well-intended piece of legislation that created the Employee

Retention Credit, and we are hearing problems about delays in getting money.

Now we've got fraudsters taking advantage of the system. There were opportunities, I believe, where we could have mitigated those damages and improved services. I think we are never going to do our job properly if we do not look back and learn from our past.

The last thing: there is one piece of advice I have given to the Internal Revenue Service. I said, "You are getting better at solving problems, but you need to do a lot better job at preventing them. I think we would all be better off if we could prevent problems and not solve them.

So again, thank you so much for the opportunity to be here today, and I look forward to the discussions going forward.

[The prepared statement of Mr. Harris appears in the appendix.]

Chairman WYDEN. Thank you, Mr. Harris. Preventing problems—that is being way too logical for anything that goes on around here.

Senator Crapo's on a very tight schedule, so we are going to break colleagues out of our order to let Senator Crapo go first, and then we will just pick up our regular process.

Senator Crapo?

Senator CRAPO. Well, thank you very much, Mr. Chairman, for accommodating me. I apologize to the panel and to my colleagues. I do have a previous commitment that I have to get to. I am glad I was able to be here for all of your testimony, and I am glad I get this brief moment to at least ask one question, which I will ask to my Idaho witness, Stephanie Camarillo.

Stephanie, thank you for sharing your story. I was particularly touched about how you were able to reinvest your tax savings in that employee whom you could move forward and help to build a stronger American dream in her life. This is exactly the type of investment that Congress hopes to encourage through our tax code. To deal with this complexity and other issues is important, but to add additional and strengthening investments through our tax code, helping our small businesses do exactly what you described, is what we need to do.

Could you just give us another little further discussion about what kind of investments you could make with additional tax or compliance savings in your business, with regard to your employees and your business in general?

Ms. CAMARILLO. Thank you, Senator Crapo. I certainly can. We have wanted, for example, to open up a child-care facility adjacent to our businesses. I think that that would save our employees time and money, and allow them to come to work much easier. So that is number one.

I always want to increase wages and incentives for them. I would love to start a scholarship fund for them. Their health-care options—we are always looking for health-care options that we are able to afford, which is a big issue for small businesses, and that meet the needs of our employees.

So that is what I would say. And, Senator Crapo, if I could, I wanted to have the opportunity, while you are here, to just address for me what is one of the biggest issues that I face, and I am won-

dering if Congress, if you could potentially work on rewarding employees a little bit better.

By this what I mean is that government assistance programs, if they could phase out a bit more smoothly. So, my company works to raise wages and create opportunities for our house cleaners. But often when we give these raises and we promote our people, it can end up being a net—NFIB helps me with this terminology—but higher marginal cost to the employees.

For example, I have one house cleaner right now. We just promoted her. She is losing—by her promotion, she is losing $700 a month in benefits by accepting this promotion. There is no incentive for them to take more responsibility, and they get trapped in poverty. I do not think that—you know, I think maybe we can all agree that that is an issue. So, thank you so much.

Senator CRAPO. Well, thank you so much for that and for that observation. I think that something that we need to learn here, as we deal with our assistance programs and our tax policy, is that we need to make it so that the math always works for the employee to take the new job or to take the higher wage, or to stick with the advancement in the private sector, rather than to say, you know, I just——

You know, they can do the math, and we need to make it so that when they do the math, the math says, "go for it and build your future." So, thank you for that observation.

Chairman WYDEN. Thank you for the point, Ms. Camarillo. We will follow it up. As I was listening to it—and sometimes with all the government lingo, it is hard to follow—it sounded to me like it was out of the benefit structure as opposed to the tax issue, but the principle is the same thing. You ought to be rewarding people for hard work. So we will follow it up.

All right. Ms. Chapman, thank you again for being here. And when I visited your company, and that young man took—in effect he had a hand-held mic or some such thing—and basically said he had a shot at a success for his family coming out of prison because of you, and his home, and the fact that his kids are now doing well in school.

That is the face of what small business is capable of, so I appreciate it. I listened carefully and was scribbling notes about some of the headaches that I had not heard about before, because I knew some of them. As you know, we talked about that. Give us your sense, because we always said that this effort can improve service and IT and make sure that everybody is held accountable.

It is just beginning. What do you think the next steps ought to be in terms of—you have four members of the committee; actually, now we have six, so you have 6 percent of the U.S. Senate ready to hear you out. What do you think the next steps ought to be in terms of the priorities and use of the funds and the like?

Ms. CHAPMAN. Thank you, Chair Wyden and Chair Cardin, for the question. I really love that you highlighted this story of one of our employees. We are a second-chance employer. Forty percent of our employees are women and people of color who have been impacted by the criminal justice system, and like Ms. Camarillo, we really invest all of our earnings back into our workforce and our community.

So every dollar that I do not have to waste on taxes and penalties that I can reinvest in my workforce is critical to those people. I mentioned that we need to properly fund the IRS. I think that is the first step. I cannot get through to the experts that I need to, to be able to get the guidance and get the refunds that we have been waiting on. The tax credits that are already available to us—we're absolutely taking advantage of those tax credits for R&D and for pass-through organizations, like Senator Crapo mentioned. Those would help us.

But even more than I need tax credits for robotics and software, I need to be able to support my workers, and we have all heard ad nauseum about the dearth of skilled labor, because we are not hiring enough women, especially post-pandemic, who cannot afford the exorbitant cost or the complete lack of child care.

So, if there are Child Tax Credits or benefits for working families to be able to hire more women, train them and get them, especially in manufacturing, to fill some of these gaps so we can be more competitive as a Nation, that would be a game-changer.

Chairman WYDEN. Right. What we will do is, we will do this. When I was doing events at home—and you probably picked up on this—as we say, there are two tracks. We will have our staff folks follow up with you on the headaches that you are up against right now, and then we will work with you, particularly on some of the steps for the future.

I happen to share your view with respect to child care. Certainly Ms. Camarillo made the same point. We can tackle this, and, colleagues, since we have so many on the Finance Committee, we can tackle this in a bipartisan way. This does not have to be another kind of food fight routine. So we will want to follow that up.

Senator Cardin is next.

Chairman CARDIN. Thank you, Mr. Chairman.

Ms. Blanding, Mr. Harris pointed out that small businesses cannot figure out the tax code on their own. They have to hire professionals or consultants or services. There was a survey released in April of this year by Public Private Strategies and the Tax Policy Center that showed that 87 percent of small businesses cannot do their taxes without outside help. So there is a need for services.

My question is one that is pretty simple, and that is, how helpful have the SBA resource partners been in helping you get the type of assistance you need in regards to the taxes? We have the Women's Business Center, now located at Morgan State University. We are very proud of that. We have our SBDCs, we have the different resource partners that are available. MBDA has programs available.

How effective have they been in dealing with the tax issues? I know they are stressed also on resources, but have they been useful?

Ms. BLANDING. So, I often refer the business owners to go to one of the SBA offices and seek resources and assistance with them, and most of the time it is that the business owners often just do not know. So, unless someone can tell them, "Here are some resources for you," they really do not know.

Most of them that I have—and my cohorts where I am teaching—they need additional help. So they join the program because

they are business owners. They have a great idea. Many of them are working in technology, so they have these new products. They could benefit from tax incentives, from special programs, but they just do not know.

And once I tell them, they are excited, and they actually connect with people who can help them. Most of the time it is really just finding someone that they can get a referral for. Even yesterday, I was talking to a business owner who has been in business for over 30 years, and her challenge is finding a trusted accounting and legal team.

Even though she has had many that she has worked with, they have not provided the quality of services that she needs. So having that referral network helps a lot.

Chairman CARDIN. Thank you very much.

Mr. Harris, I agree with you and the chairman that we do need standards for paid preparers, and I appreciate the fact that you mentioned that. We heard about the IRS not being responsive to the needs. Are there services that the IRS provides? We know that they have the publications that they provide. They have, in their strategy plans, helping small businesses get through the tax code.

How effective has the IRS been in trying to fill the small business literacy gap for taxes? How effective has the IRS been?

Mr. HARRIS. I think I would give them an "A" for effort, but not necessarily an "A" for its usefulness, because it becomes too legalese. It is too much just "this is the law," and unfortunately for any outside group to advise a small business, the law does not always fit perfectly. You have to take the law and apply the facts of the individual business owner or the situation there.

So, it requires some interpretation, and I think the IRS needs to—if they are going to continue to do this, which they should, they have to speak more in plain English. They have to talk to the more real-world situations that we find ourselves in, not just quote the law—so, "this is what the law says."

They are trying, and they are trying to get better with FAQs and other things. But again, it is the application of the law through the particular circumstances of a business that presents a challenge for them, and to some extent the SBA, because they do not have those facts in their database.

Chairman CARDIN. Thank you. Thank you very much.

Chairman WYDEN. Thank you, Senator Cardin.

Senator Young is next.

Senator YOUNG. Earlier, I brought up the unexpected tax hit that our businesses are facing when filing taxes. Their experiences in their 2022 tax filings due to the shift to amortization—hopefully, I can get that word down there—of R&D investments.

Mr. Norris, can you just quickly, hopefully concisely, describe the impact amortization has had on Warrant Technologies this year?

Mr. NORRIS. Yes sir, Senator. In 2021, we expensed $347,000 of 174 R&E cost. In 2022, we will be able to expense $27,000 of $277,000 spent. It is going to delay and impact our ability to meet our growth needs, improve our benefits for our employees. We have had to shelve a product that we are in development on and shelve an R&E project.

Senator YOUNG. So you are basically, in order to pay your taxes, you are having to starve future growth and future innovation associated with that growth; is that accurate?

Mr. NORRIS. Yes, 100 percent. At our size, you would expect a company—I would expect a company our size to have a full-time HR officer, a full-time CIO, with what we deal with. Those hats are shared amongst, like on a small ship, many people. We are getting to a critical mass where we cannot have that, and we need to be able to manage that growth, bring those resources on. We simply cannot do it.

Senator YOUNG. You bring efficiencies to the Pentagon. You innovate in areas that are essential to our warfighters. We have just gone through an episode here where there has been much handwringing, a whole lot of sturm and drang on the floor of the United States Senate about the difficult decisions we are making related to our Pentagon.

You could help us with all those things if we provided some relief through the tax code. Is that accurate?

Mr. NORRIS. It is 100-percent accurate. The restoring of these tax expenses—we have had to hire not only a CPA full-time, but we have had to hire outside tax authority and expertise to manage this for us. The findings—what we are finding is scary. It causes sleepless nights. A wrong step in this way could mean the end of Warrant Technologies.

Senator YOUNG. I am going to remember a lot of your testimony. Let me assume that my colleagues remember one thing, one thing. You have no more time to wait. Similarly situated businesses have no more time to wait in order to restore full and immediate expensing. It has to be done this year. What are the implications for your business if it is not?

Mr. NORRIS. The decreased cash flow is paramount. It impacts everything, and we have heard it across the panel. The ability to take care of our employees is first and foremost. That is critical, and that is part of the growth need. That is the core of it. Putting the right benefits in place, putting the right education, putting the right wages in place, we are able to better manage that growth.

The R&E and the product are things we would love to do and things that are important—and they create jobs. It has spun off another company already, and that company is at risk with all of this. So that is what is at risk.

Senator YOUNG. Thanks for being here.

Chairman WYDEN. I thank my colleague.

Senator Johnson?

Senator JOHNSON. Thank you, Mr. Chairman.

Just a general question to all of you. Anybody want to defend the tax code?

[No response.]

Senator JOHNSON. I did not think so. From what we talk about here from my standpoint, as a small business guy myself, an accountant—literally putting band-aids on a dying patient. So, rather than talking about tax reform, what we ought to be talking about is dramatic—and I mean dramatic—tax simplification and rationalization. Would any of you disagree with that?

[No response.]

Senator JOHNSON. Based on principles, things like wherewithal to pay—now, I appreciate the fact that you gave me credit for the 199. That is not the way I would have fixed it. I also would have made it permanent. But it does not come as a surprise. I was not a big fan of what we did in 2017. We had an opportunity, a generational opportunity, to dramatically rationalize and simplify our tax code, and we did not.

We made it more complex, and we made the changes temporary. Let me just tell you what we did. American businesses have to be competitive; no doubt about it. But the OECD average tax rate is about 25 percent. Now, we had a corporate tax rate of 35 percent for C corps, but that was only 5 percent of American businesses.

That is right. To step into the world, we are going to leave 95 percent behind, paying individual rates. Back then the effective rate—and here is proof that our tax system is broken. We had a nominal tax rate for corporations at 35 percent, but a marginal tax rate of about 21 percent.

That is absurd. That is all this social and economic engineering through the tax code. Why not simplify it, based on again, wherewithal to pay? Why not cash-based income? You can do away with all this complexity. You know, when we did our R&D tax credit in my business, the folder was so thick. You know who had to prepare that folder? My engineering guys, which took them away from innovating products and making things more efficient.

So, what we did in 2017 then is, we dropped that marginal tax rate for C corps from 21 percent for both large and small C corps—it was very even—to about 10 percent for large C corps and about 14 percent for small C corps. Unfortunately, because we got the 199 deduction in there, we made sure the top marginal tax rate for pass-throughs is a little under 30 percent.

Now again, I do not have the effective rate for pass-throughs, but all of you, you are small businesses. You are competing with C corps at the entity level; correct? So, you are competing at the top marginal tax rate of 30 percent when C corps have a marginal tax rate of 10 to 14 percent. That puts you at a competitive disadvantage as well.

So, part of the rationalization of our tax code is, treat all business income equally, so that businesses at the entity level are competing equally. I do not like the double taxation dividends. The fact of the matter is, only about a third of C corp business income is taxed doubly.

So, Mr. Norris, you are the one that I think was talking about the fact—you know, let us try and prevent problems. So, would anybody here, maybe Mr. Harris, would anybody here not want to see a dramatic simplification of our tax code, go to cash-based income? Will somebody just talk about how simple that would make things, and how it would equalize treatment?

Mr. HARRIS. Well, in our written testimony, we talk about the importance of the cash basis, that the one book of record that all businesses understand is their checkbook. They know when things are going up, things are probably good, and when things are going down, things are probably bad.

And tying tax expenditures to when the money is available would always be better. So, the expansion of the cash basis is something

we have always supported anywhere that it is possible, because, again, it makes it easier for the business owner to understand.

Senator JOHNSON. There would be a short-term timing difference, but in the end——

Mr. HARRIS. At the end of the day, you pay the same.

Senator JOHNSON. So again, Mr. Chairman, what I am really begging you to do is let us sit down as a committee or in an office, and let us go through the basic principles that we need to achieve here: simplification, rationalization, based on things like wherewithal to pay.

If we would do that, we could dramatically simplify our tax code. It would be a lot easier to comply with. You know, Senator Cardin said that businesses have to—the IRS has to help businesses get through the challenges in the tax code. Well, the solution there is not to have the IRS help them get through the challenges; eliminate the challenges, simplify it.

So that is what I think this committee ought to focus on, rather than, again, putting a band-aid on the dying patient.

Chairman WYDEN. I thank my colleague. I want to go Senator Hirono. I would just say to my colleague, before you were on the committee, I devoted years putting together two major bipartisan proposals, first with Senator Gregg, then with Senator Coats. I am still interested in it, and the heart of it ought to be simplification, no question about it.

Senator Hirono?

Senator HIRONO. Thank you, Mr. Chairman. I thank both chairs for this joint hearing. Clearly, the tax code is complicated. There are whole law school courses figuring out what is in the tax code. In fact, Mr. Harris, you help a lot of small businesses with filing their taxes. If you were to bring in the tax code, how high would the stack be——

Mr. HARRIS. If I had to——

Senator HIRONO [continuing]. Of the provisions?

Mr. HARRIS. If I had to do what to the tax code?

Senator HIRONO. No, the tax code that you represent—you help a lot of small businesses with their taxes. I just want to get a visual sense of how many pages the U.S. tax code now covers?

Mr. HARRIS. Oh, I have no idea how many pages, but——

Senator HIRONO. It is a lot.

Mr. HARRIS. There is a lot, and it is sometimes overwhelming. I think that is why you have to focus on who your customer is, because it is impossible to absorb the entire tax code. You have to focus more on who you try to serve. So we try to focus on the parts that impact small business.

Senator HIRONO. And hope that you do not miss anything, right, that may impact small businesses?

Mr. HARRIS. We do our best.

Senator HIRONO. I mean, is there a section in the tax code that says, these are the provisions that apply to small businesses, with a definition of what a small business is?

Mr. HARRIS. No, it is everywhere. I mean there is not one book. It is all over.

Senator HIRONO. Yes. So, as you work with small businesses, what is it that they are most concerned about, regarding making

sure that they are filing their taxes appropriately? Do they say to you they have to come to you because they cannot even make heads or tails of the tax code as it applies to them?

Mr. HARRIS. Sure. They have given up hope of trying to do it themselves, because there are so many complexities. There are benefits in the tax code. The Employee Retention Credit was a benefit that they could have taken advantage of. They had to know about it; they had to know how to do it. They had to know all of those things.

They want to make sure that they are not paying any more than they have to. They want to make sure they are paying what their competitors are paying, and they expect fairness. So, they want to do things the right way, but it is just beyond their ability.

Senator HIRONO. And that is why you are there, because they had to figure out themselves——

Mr. HARRIS. That is why we have survived for almost 60 years, yes.

Senator HIRONO. Mr. Norris, thank you so much for bringing your own perspective to what you have to do. So, as you indicated, you had to hire your own CPA and other people just to help you. So you do not use a service like Mr. Harris's. You do your own taxes?

Mr. NORRIS. No, ma'am. We have a CPA firm that we hire, and then on top of that, to deal with this, we had to go outside of that and then hire another tax specialty firm to help us work through this. That is on the advice of our CPA, and they have a representative in the room with us today.

Senator HIRONO. I believe that you testified, you discussed the importance of restoring the research and development tax deduction in your testimony?

Mr. NORRIS. Yes, ma'am.

Senator HIRONO. So, can you elaborate on why restoring this deduction would be so important to your business in particular?

Mr. NORRIS. Absolutely. The operational funds, the cash flow that is removed from Warrant—and I talked a little bit about it; the whole panel has really. Again, first and foremost is taking care of those employees. But with the dollars left over—we have a history, and all small businesses in our line do; this is not unique to Warrant. We have a history of pursuing opportunities in product development. We have heard that from the panelists today.

We have a history of pursuing new technologies, and certainly that is true of Warrant. Those get shelved. As a matter of fact, we have had to shelve the R&D project that we have underway right now, because we just do not know what we are facing, and we have had to shelve the product that we are in development on right now.

Senator HIRONO. Do the other panelists agree that we should contemplate restoring the R&D tax deduction? Yes, I see at least two heads nodding.

Ms. CHAPMAN. I agree.

Senator HIRONO. Yes.

Ms. CHAPMAN. Absolutely. I think that would be critical for many small businesses, especially those that are innovating to make America more competitive. And advancing those credits to be more competitive, specifically with China, is key.

Senator HIRONO. Ms. Camarillo?

Ms. CAMARILLO. Ditto. I have a house cleaning business, so it is not relevant to me, but I am president of the Entrepreneurs' Organization, and it is vital to entrepreneurs.

Senator HIRONO. So, for the two chairs, I think this is definitely something that we should contemplate doing. It is to enable our small businesses to keep up with things so they effectively compete. I have no idea what the time is. I may have gone over 5 minutes. I do not have any—have I gone over 5 minutes?

Chairman WYDEN. Yes, but the fact is, in the broad sweep of western civilization, this will not be a big problem for you. I thank my colleague, and I want her to know, seriously, that it is top priority business on the Finance Committee on a bipartisan basis to resolve this and get it done this year.

Senator Risch?

Senator RISCH. Well, thank you, and I want to thank both chairmen and both ranking members for holding this roundtable. It is certainly an important matter, as we have all heard today. I want to thank all our guests for sharing their stories. These stories exemplify the important role of small businesses in driving economic growth and innovation.

In Idaho, 99 percent of our businesses are small businesses, and their impact on the State is tremendous. Behind each is an Idahoan like Ms. Camarillo, who had the tenacity and was allowed to achieve the American dream. We really need to promote an economy where these entrepreneurs can invest in their business and employees.

Our tax code accomplishes the opposite. Small business owners often fill several roles in their companies and have neither the time nor the expertise to parse through the onerous requirements. A survey from American University found that tax complexity caused nearly half of small businesses to struggle with their taxes, and almost 90 percent outsource these issues. They should not have to.

This has driven compliance costs 67 percent higher for small businesses, according to the NFIB, National Federation of Independent Business. This is unacceptable. Congress must support businesses by simplifying the tax code.

In addition, small businesses rely upon the Tax Cuts and Jobs Act pro-growth policies. Ms. Camarillo's story, for instance, demonstrates how the TCJA's small business deduction, the 199A deduction, achieved Congress's goal of facilitating growth and reinvestment. Many of these provisions, however, expire in 2025.

In today's uncertain economy, Congress must take meaningful steps to support our Nation's small businesses, beginning by extending these policies.

With that, I am going to close, Mr. Chairman. I apologize for not being here. We have a Foreign Relations Committee going on. The backlog on issuing passports that every single member of Congress——

Chairman WYDEN. Off to backlogs.

Senator RISCH. So we are drilling down with the State Department on that. I may have some questions for the record though.

Chairman WYDEN. Absolutely.

Senator RISCH. And thank you to our witnesses for showing up.

Chairman WYDEN. Very good.

Senator Tillis?

Senator TILLIS. Thank you, Mr. Chairman. Thank you all for being here.

Ms. Camarillo, can you speak to the importance—you may have spoken before; I am sorry. I have dueling committees with Judiciary. But how important is section 199A, the pass-through deduction, for small business? Can you talk a little bit about it applied to your business enterprise?

Ms. CAMARILLO. Yes; thank you. It has been extremely important. I talked about how we used it. You know, my company is small, so for us, it is around $15,000 a year. But that is significant for us. So we were able to actually promote two people with that savings.

Senator TILLIS. What changes if it sunsets at the end of 2025?

Ms. CAMARILLO. You know, it will impact our ability to grow, because I cannot—you know, where am I going to get that money to make that investment in my business?

Senator TILLIS. And I believe NFIB is fully supportive of making it permanent?

Ms. CAMARILLO. Oh absolutely, and a shout-out to NFIB. They have been fabulous, yes.

Senator TILLIS. Mr. Harris, can you talk a little bit about the impact that repealing the estate tax will have on small businesses?

Mr. HARRIS. What do you mean? Taking it back to a lower level?

Senator TILLIS. Yes.

Mr. HARRIS. Well, certainly, any time you put a tax on something, it has an impact. Any business that would be over the threshold of whatever the new number would be—it would mean that there is a cost of that transition in a business. It could cause them to sell things.

Senator TILLIS. What if we completely repealed it?

Mr. HARRIS. For businesses in our market, we do not have a lot of people, unfortunately, who create enough wealth to be burdened by it today. But certainly, for those who are—any time you put a tax on an activity, be it death or whatever, it impacts it.

So, for any business that currently would be subject to the estate tax, removing that tax would allow that money to stay in the business and be spent for things——

Senator TILLIS. We have a lot of small and medium-sized businesses that are maybe capital-rich or land-rich but cash-poor, and it is one of the reasons why we actually repealed the estate tax in North Carolina, the State component.

Mr. HARRIS. Any time you tax something when there is no economic transaction to generate cash to pay it, it creates a burden, because now something has happened that causes tax to be due, and yet there is no cash being generated at the same time to pay for it.

Senator TILLIS. I am glad we are having this meeting in this sort of setting, but what we are really talking about are band-aids on what I believe is a tax code that needs to be dramatically simplified. I know it can work. We did it in North Carolina, back when I was in the State legislature.

A lot of the opponents are really rethinking. I do not think we have the balance right in terms of taxes on productivity versus consumption. I think you have to open the aperture and modernize our tax code, and when you do that, you can simplify greatly. Speaking for North Carolina, if you do it right, you can have an enormously positive result.

Over a 10-year period, the economy has transformed. You have to deal with all the hits. If you get into a consumption-based framework, then you are going to get hits on the regressive nature of a sales tax, for example. That can be dealt with. We dealt with it. You can reduce the corporate tax. You can reduce the personal income tax, and you can put a lot of small businesses back in business.

Eighty percent of the job creators in North Carolina are small businesses. But we started with the band-aid approach—you know, making sure we got pass-through income done, seeing what we could do on the estate tax, all those things, and then we just decided to remove all these irrational exceptions and exemptions, tried to smooth it out, make it easier for small businesses to understand.

And so, I hope that, right now, we can fix some of these band-aids, particularly the ones that are subject to a sunset. But I hope we can get into a fuller discussion of how we should rethink the entire tax code, and that will not happen quickly. But the discussions of the possible really need to happen.

You know, small business—I do not know how many committees I have been in where people are talking about a new regulation, and then the witness will say, "Well, it is only one more form." And I say, that is fine if you are talking to the vice president of compliance in a large corporation.

But when you are in a small business, the same person who has to fill out that form and deal with that government agency is probably the CEO, the CFO, from time to time the janitor, and all things in between. And we have to understand that that complexity hurts the very sorts of business enterprises that we admire the most, because you create the most jobs and you have the most impact on your local communities.

So hopefully, we can get to a point where we can start having that discussion. The band-aids are important, but I think fixing the underlying wound is more important, and that is the complexity of our tax code.

Thank you all.

Chairman WYDEN. Senator Tillis, you got me at "hello" on the basic proposition: a more comprehensive tax reform with the foundation being simplicity. And just to give you an idea of the history, I wrote what is still the only comprehensive bipartisan tax reform proposal in decades with the Senator who sat where you now sit on the Finance Committee, Senator Dan Coats. So let us go to it. I am happy to work with you on it.

What we are going to do now is, Senator Cardin and Senator Young have one additional question. I am going to have to go, with apologies to Ms. Chapman. I do want to make one quick point, which is, in the IRS proposal, what is called the Strategic Oper-

ating Plan, there are several areas of special interest to small business.

I am going to work very closely with the chairman. We will do it in a bipartisan way, the Small Business Committee and the Finance Committee, as these go forward. But as I understand it, they are looking at a system of online accounts, so that a small business person could get everything they wanted about their tax situation online, and apparently there will be some people to answer questions from small business people as well.

So the point is, this is still in the development stage, but I want it understood that the Finance Committee and the Small Business Committee will work together in a bipartisan way, cooperatively, to make sure that these issues which touch on a number of things that you all have talked about this morning, go forward in an expeditious sort of fashion.

So, Senator Cardin will close the hearing, and that will take place after he and Senator Young have had their additional questions. I want to thank all of our guests. This has been very helpful, very constructive. Particular thanks to Ms. Chapman, because I will never ever in my time in public service forget the face of that young man just out of prison whom you gave a shot to. You gave a shot to that young man, and that, I think, is the best of small business.

So, Senator Cardin, Senator Young, all yours.

Chairman CARDIN. Thank you, Senator Wyden. And before you leave, I just really want to thank you for your attention to small business as chair of the Finance Committee. I can tell you, during the COVID experiences, when we were putting together a package to help small businesses, Senator Wyden was a great advocate on behalf of our smaller companies, and to keep them alive during the pandemic. So, thank you so much for your attention to the small business issues.

Mr. Harris, I want to try to get your view on the inequities in our tax code. Let me tell you, I start with the challenges small businesses have in compliance, and we have already talked about that with the tax literacy issue.

I have always been concerned about the fairness of our tax code for small businesses, because they are within the individual tax structure rather than in the business tax C structure. So, the 2017 tax bill—we have different views on it. I thought it did not help the situation; I should have thought it hurt the situation a little bit with the ways that the rates were changed for C corporations and the pass-throughs, for the entities.

I say that because there are a lot of pass-through entities that I do not consider to be small businesses. They are making their decision on what is in their best interest, and it is much better for them to be individual taxpayers rather than having the entity pay taxes, and they make that judgment, and we give them the right to make that judgment.

I am not complaining about that. But the 199A, I did not think was focused on really helping small businesses as much as pass-through entities, which are not necessarily small businesses. So, I guess my question to you—if we are interested in helping small

businesses, and we are interested in giving them a break, we have special rules to try to help small businesses.

Is there a better way to try to focus the 199A section or other sections of the code to really target the small companies, the smaller entities? We also learned—one last question, and I will let you respond.

We also learned during COVID that there is a big difference between a company that has 500 employees and a company that has three employees. Is there a way that we can provide the help to those companies that really need the help, the smaller of the small businesses?

Mr. HARRIS. There is a lot there, and what is sad about the current state of small business taxation is, they only understand one number on their return, and that is the final number.

Everything that got to there is beyond their comprehension, and so when we talk about 199A or this or that, they just kind of look at people like us and say, "Tell me how I did." If I can tell them that it saved them money, they are for it. If I tell them it costs them money, they are against it.

So I go back to making their system of taxation and record-keeping tie to something that they do understand: how are they doing monetarily in their business? And I think in the simple world, if you take the money in, the money out, the money left, and apply a rate to it, they could understand that.

It is everything getting to that that confuses them, and they are left with just, at the end of the day, how much do I owe or how much do I get back, and that is about all they understand. They do not even want me to try to explain it to them, because they still would not understand it.

So, at this smaller end of small businesses, we need to just work in a world that they can comprehend. When we talk about this deduction, that deduction—we have heard a lot about the R&D credit. What is confusing is, I spent $100,000 and I can only deduct $10,000, but I am out $90,000 more, you know?

Tie it back to where their world is and they can wrap their brain around it, and I think they would all be thrilled.

Chairman CARDIN. That is why I thought 179 expensing worked well, because they could understand it dollar-for-dollar.

Mr. HARRIS. Exactly.

Chairman CARDIN. So more of that type of——

Mr. HARRIS. More of that type, yes.

Chairman CARDIN. Thank you.

Senator Young?

Senator YOUNG. Thank you, Mr. Chairman. I want to thank you and Senator Wyden for prioritizing our small businesses, and it has been a very thoughtful hearing. Thank you to all of our panelists.

In my closing time here, I just wanted to underscore a point. Since there seems to be universal support among my colleagues who appeared at this hearing for the R&D provisions, eliminating amortization, what has happened? Well, in the House of Representatives, there was an insistence from a clutch of members. They happen to have been Democrats. We all have our own politics and party affiliations, so they are good Americans. But it was their fer-

vent belief that we needed to restore the Child Tax Credit as it previously existed.

They decided peculiarly to—I will indelicately say—"hold hostage" the R&D provisions to that policy objective. Now it is an unusual thing to do, because the R&D has historically had bipartisan support, as it still does. You would typically say, you know, that Republicans are going to have to give on something that tends to be a Republican-only imperative in order to get your Democratic legislation moving, but that is not what they have done. The mantra, typically uncontested, that we are hearing from them and from some members in the U.S. Senate, is, before we move on R&D, we need to do something for working people.

Mr. Norris, you have 50 employees. Most of them work pretty hard, by observation. I had an opportunity to visit with you. They are working people. And for those who categorically think that someone who has a Ph.D. or advanced degrees—does everyone among your 50 employees have advanced degrees in your R&D-intensive business?

Mr. NORRIS. No sir. We have everything from high school graduates all the way through Ph.D.

Senator YOUNG. Okay. So, to the extent we are able to advance this provision, which is essential to the future of your business, we also help those working-class people. Is that accurate?

Mr. NORRIS. Every dollar we can keep, the first place it goes is to help those people. What we do is, we increase our education benefits. We increase benefits. We increase their health care. If we cannot retain and attract that talent, that talent from the interns, the high school graduates, through the Ph.D., then we do not have a business.

Senator YOUNG. Right. And some of that money that goes in their bank accounts, goes in their pocket, Mr. Norris, presumably goes to Ms. Camarillo to pay to clean their homes. Has that been your experience? Is that maybe one reason why you support the R&D provisions?

Ms. CAMARILLO. Absolutely.

Senator YOUNG. To help those working people?

Ms. CAMARILLO. Yes, that is it.

Senator YOUNG. The employee.

Ms. CAMARILLO. I do not even have more to comment other than "yes."

Senator YOUNG. Okay.

And, Ms. Chapman, your company specializes in custom complex metal manufacturing. I do not even know entirely what it does. I know you developed some proprietary welding technology that sounds very impressive.

It also sounds kind of cutting-edge, which is why you testified that you need the R&D provisions restored. Do you have working people in your company too?

Ms. CHAPMAN. Yes, of our 42 employees, we primarily employ welders, machinists—so, trades craft people and also engineers.

Senator YOUNG. Okay. Well, we want your company to continue to thrive. One of the ways we can do that is by eliminating the amortization of R&D expenditures and helping the working people who are in your employ.

So that is all I had. I just wanted to make sure that that very obvious point, to so many, is not lost in the talking points that are circulated in Washington. Thank you.

Chairman CARDIN. First, to Senator Young, who is one of my dear friends, and I mean that sincerely: we have partnered on many bills. Many have been signed by the President of the United States, because we have worked together in a very bipartisan way in many, many different areas.

I just have to take exception to the manner in which you presented the R&D. I am for fixing the R&D. It does affect small companies, particularly SBIR and DTR companies. It is one of the issues we hear the most about.

We've got to fix what was done in 2017. But to say that this is a challenge because of other issues that may be attached to it—why do we have the problem with the R&D? It was put in the 2017 tax bill, which was a partisan tax bill, as a way of saying we are paying for tax cuts when in reality it did not pay for the tax cuts. But it was part of a package of bills put in by the Republicans.

Now, I am for fixing the R&D credit. I think we need to do it, and I am for working out a reasonable package to get that done. But I think it defies the traditions of the U.S. Congress and the way that we deal with tax bills, to say that it will not be considered with other tax provisions.

We always do that, and we try to balance it. As you know, I have many, many good bills in health care and in taxation and in pension areas that I would love to see considered by themselves on the floor of the United States Senate. It is not going to happen. They are going to have to find a home within a package of bills, because we do not have the time to bring up individual bills.

We always put them into these larger packages. So I just really wanted to set the record straight. I am for fixing the R&D. It is a bipartisan bill. We need to get it done. We need to find a home for it, and what is in that home, what is in the package, I hope that our team can negotiate.

I have a lot of confidence in Senator Wyden and Senator Crapo. They have worked together long and hard, and we have gotten—the last Congress we got a great pension bill done thanks to their leadership, and it was a good package that included a lot of provisions that Senator Portman and I worked on.

So we do this all the time, but I think it is not reasonable to expect that we will have an individual bill on the floor of the United States Senate on taxes. I do not think that is going to happen. I could be wrong; I just do not think that is going to happen.

Senator YOUNG. Thank you all for coming.

That is all, right?

Chairman CARDIN. No, I did not mean to—but thank you all. I asked Senator Wyden and Senator Crapo to do this roundtable discussion. When I ask small businesses, as the chairman of the committee, what their top priorities are, we will hear access to capital, yes. We will hear workforce issues, trying to get workers. We will hear about supply chain issues. We will hear about cybersecurity.

But we hear about the frustration of dealing with the IRS, this frustration of trying to understand how these tax provisions work.

And, Mr. Harris, I could not agree with you more: they look at the bottom line, but how they get to the bottom line, they have no idea.

And when they get caught with a situation where they could have gotten better benefits but they did not know about it, deductions that they did not take, or all of a sudden they are being challenged on what they did and they had no idea, or where there is an expiration of a tax provision and they had no idea that the tax provision expired, all that is extremely frustrating to a business owner who does not really have the resources to understand other than what the bottom line is to that person.

So I think this has been extremely helpful, and I thank each of you for your contributions. This will not be the last time we are discussing this, and since this is very informal, I see someone raised their hand. You are trying to add something to this?

Mr. NORRIS. The 174 amortization will impact Small Businesses this year. When will it be fixed?

Chairman CARDIN. That is a very good point. And one of the challenges we have in Congress is that our calendar on getting tax changes done does not necessarily comply with the IRS calendar for filing returns and when returns are started, et cetera.

And it just cries out for predictability. The more we can do permanent tax provisions rather than temporary tax provisions, the more we can settle tax policy—bipartisan—so it has a chance of surviving more than a few years. It is in the best interest of the taxpayers of this country.

So that is why you are going to find that Senator Young and I both very strongly believe in bipartisan solutions to tough problems, because it gives us the predictability we need moving forward. Your point that you raised is very valid, and something that drives us to try to get this resolved as quickly as possible.

Thank you very much, and with that, the roundtable discussion will come to an end.

[Whereupon, at 11:45 a.m., the roundtable was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF AVONETTE BLANDING, CPA, MBA, OWNER, BLANDING FINANCIAL SOLUTIONS, LLC

Chairman Cardin, Chairman Wyden, Ranking Member Crapo, Ranking Member Ernst, and members of the committees, I sincerely appreciate you inviting me to share my perspectives on the tax literacy gap and how the IRS and SBA can better coordinate and improve services. Tax literacy, competence or knowledge of the tax code and laws, is a challenge to many individuals and small business owners. I developed my initial tax literacy while completing my undergraduate degree in accounting and later demonstrated my competence when I earned my Certified Public Accountant (CPA) license. When I meet people and share that I'm a CPA, there inevitably is a reference to taxes, after which I laugh and then reveal that I haven't been a practicing tax accountant in decades but am fortunate to have many talented tax accountants in my network. Like many other Americans, I have multiple roles, including that of small business owner. I realize however that for many of my fellow small business owners, especially minority owners, tax literacy is not their comfort zone nor greatest area of expertise.

For the past 2½ years, I've had the privilege of working as an accounting subject matter expert and facilitator with Morgan State University's Baltimore Means Business (BMB) entrepreneurship growth program. In that role, I facilitate training and provide business advice for aspiring and established minority small business owners. I introduce participants to topics and practical information necessary for running the day-to-day operations of a growing business. I secure subject matter experts to participate in a panel discussion of small business accounting, tax, and technology issues. While supporting the BMB program, I've met with over one hundred entrepreneurs and small business owners and during each panel discussion, most of the questions centered around taxes. One of my guest panelists, Albert Hurston, CPA, shared that "taxes are really complicated to a lot of small business owners because they know that there are a lot of rules and regulations, but they don't understand which rules apply to them." In addition to not knowing which regulations apply to them, many minority business owners are unaware of the tax incentives available to them. This lack of understanding and lack of knowledge can have a significant and direct impact on the success and financial health of the business. I suggest that the SBA improve advertising and promotion of the tax planning resources provided by SBDCs.

Many minority serving institutions (MSIs) and Historically Black Colleges and Universities (HBCUs) have entrepreneurship accelerator and business incubator programs. The IRS should consider coordinating with those MSIs and HBCUs to provide resources to support tax literacy workshops and seminars to the entrepreneurs and small businesses owners participating in the programs.

Small business owners and tax practitioners who proactively call the IRS to seek assistance often experience extremely long wait times. The IRS should continue to implement changes to reduce the long wait time for IRS customer service calls. In preparation for the roundtable, I contacted fellow CPAs for input. Samantha Bowling, CPA suggested that the IRS provide a small business supported hotline or chat option on the IRS website. Mr. Hurston suggested that the IRS provide more examples of "important taxes to understand for service providers" or "important taxes to understand for restaurants" or similar types of information that could be helpful for many small business owners.

In summary, small business owners want to comply with the tax code and understand their tax obligations but they also want to understand and take advantage of the tax incentives that are available.

Thank you for your time, and I look forward to your questions and answers.

PREPARED STATEMENT OF STEPHANIE CAMARILLO, OWNER, MOLLY MAID OF BOISE AND THE TREASURE VALLEY, ON BEHALF OF NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Thank you, Chairmen Wyden and Cardin, Ranking Members Crapo and Ernst, and members of the committees, for taking time to listen to a small business owner. The small business deduction, also known as section 199A, has made a difference to our business, and I'm here to tell you how.

My name is Stephanie Camarillo, and I have owned one of the largest residential cleaning businesses in our region, Molly Maid of Boise and the Treasure Valley, for over 15 years.

Many of our 42 employees are single mothers, some from immigrant families. Most have never attended college or trade school. It's easy to think that working for a cleaning company is a dead-end job. There is a lot of dirty work, but my small business has had a unique opportunity to impact the lives of our workforce and their families in ways that can address underlying issues and create generational change. It's what makes mine and other small businesses like it such a vital part of a thriving community.

We have learned that one of the most powerful ways to grow our company and retain the very best talent is to invest in our people. There are the well-known ways of investing: paying well, providing meaningful benefits, and offering a supportive environment. But there are also other ways to invest that small businesses are uniquely able to understand.

We noticed that our employees were working hard but not getting ahead in their lives. When we got under the surface, we realized that while our employees were smart, they did not know how to manage money. Financial literacy was something we could tackle and teach our employees. We set out to help them understand how to pay off debt, create an emergency fund, improve credit scores, save for college and retirement. It worked! Now, close to half of our workforce own their own homes. These investments have also helped our bottom line and resulted in low turnover and an engaged workforce.

In 2018, the small business deduction (section 199A) allowed us to make a meaningful investment in an employee named Jasmine.

Jasmine is a single mom who felt trapped and unable to advance in her life. She started working for us as a house cleaner about 6 years ago. She cleaned during the day and at night she worked to finish her GED. Because of the tax savings through the small business deduction (section 199A), we were able to give Jasmine the raise and promotion she had earned, and now she is on our management team. She has continued to spread her wings and is bound to be promoted again.

Tax relief saves jobs and elevates working families.

I admire bigger businesses and corporations, but small businesses don't have the same access to resources. Our business, like so many others, continues to feel pressures in the economy: inflation, a tight labor force, supply chain constraints.

We were challenged recently in our business when Amazon built a large facility near our office. We lost employees due to Amazon's big signing bonuses and promises of high wages. We really struggled with staffing while Amazon was ramping up.

Wouldn't you know it! Amazon has since scaled back this facility.

My company remains. It's because Congress had the foresight to pass the small business deduction (section 199A) that helped us to weather this storm.

I am not a tax expert, but I will conclude by saying the small business deduction (section 199A) has made a difference for our business. Unless Congress acts, millions of small businesses like ours face a substantial tax increase in a few short years, which will be extremely problematic. I urge you to make this deduction permanent.

PREPARED STATEMENT OF ALICIA CHAPMAN, OWNER AND CEO, WILLAMETTE TECHNICAL FABRICATORS

Dear Chair Wyden, Chair Cardin, and members of the Senate Committee on Finance and Senate Committee on Small Business and Entrepreneurship:

Thank you for the opportunity to provide written testimony and participate in the Tackling Tax Complexity roundtable. My name is Alicia Chapman, and I am the owner and CEO of Willamette Technical Fabricators, based in Portland, OR.

My company is certified by the Small Business Administration (SBA) and in our home States of Oregon and Washington as an economically disadvantaged woman- and minority-owned small business. We specialize in custom complex metal manufacturing, focused on transportation and clean energy infrastructure such as bridges and hydropower dams. We have grown rapidly and provided high-skill, high-demand, family-wage jobs to over 40 employees, avoiding layoffs through the pandemic and more recent recession concerns. In spite of our success, we are currently at a crossroads, in large part due to excessive delays within the IRS.

Willamette Technical Fabricators has conducted substantial research and development (R&D) throughout our startup years, and we were recently awarded a Small Business Innovation Research (SBIR) grant from the Department of Energy to develop proprietary robotic welding technology that will improve American competitiveness and help our Nation become more resilient and energy-independent. Unfortunately we have been unable to finalize our 2022 business tax return and were forced to file for an extension while we await updated IRS guidance on capitalization and amortization of section 174 for research and experimental expenditures. We are already struggling with the updated requirement for the first time in 70 years to amortize these investments over time, instead of being able to immediately deduct our R&D expenses. This is a stark contrast to the 200 percent R&D deduction provided to our Chinese competitors by their own government. But while we anxiously await the passage of legislation that would address this gap, the delayed guidance is holding up hundreds of thousands of dollars in tax credits and refunds that we need to continue to innovate and invest in workforce development.

In addition to R&D credits, my business qualifies for over $125,000 in Employee Retention Credits (ERC) for maintaining and expanding our workforce through the pandemic. We have been waiting on that payroll tax refund for over 8 months now. When we've been able to get through to someone at the IRS, which is rare, they have informed us that processing of ERC refunds is taking up to 160 days, unless there are any delays, in which case it could take much longer. Unfortunately no one has been able to clarify what might constitute a delay, or offered any suggestions for steps we could take to help expedite the process. With so many taxpayers, especially small businesses, hoping to take advantage of the ERC program, our accountants have told me that they have been seeing long wait and processing periods for all of their clients, and I have heard from many of our partners that this is sadly the norm. I cannot go a day without getting a call from a blocked number for someone promising to help me get my ERC refund faster, or offering to provide a predatory loan against it, because this has become such a pervasive problem.

Finally, in what I assume was an effort to supplement qualified IRS agents with artificial intelligence, earlier this year I received proposed corrections to my already accepted 2020 personal tax return, related to a 401(K) distribution I was able to take via the CARES Act to invest in startup costs for my business without the usual early distribution penalties. I provided clarifying documentation and verified my eligibility under CARES Act section 2022 within a few days of receiving an unexpected bill from the IRS for these erroneous corrections, but it took months to get a response, and then it was only that the information was still being processed. Until this issue is resolved, the IRS is withholding a refund of over twenty thousand dollars for my 2021 personal tax return, which I have also been waiting on for over 8 months. The agents I have spoken to about this have all apologized that they are incredibly short-staffed and dealing with an immense backlog. This refund is money that I would have undoubtedly reinvested in my business, like so many small business owners who are the first line of defense when their companies need a short-term loan.

While we wait for 2021 refunds and the long-overdue guidance from the IRS delaying even greater 2022 refunds, we are essentially financing the Federal Government for hundreds of thousands of dollars that we have to borrow at record high interest rates, which has created a cash flow crisis for my business. I have also had to pay our accountants almost double what we budgeted for tax support, to navigate

the ever-changing tax codes, revise estimates while updated guidance is still pending, and regularly follow up with the IRS on our missing payments, since my staff and I have spent countless hours trying to get through that would have been far better spent focusing on our core competencies. I have estimated that between interest paid for capital loans while the IRS withholds money we critically need now, and the additional tax preparation and follow up fees we've incurred this year alone, we could have hired another full-time engineer. On top of these direct costs, I have applied for an increased line of credit to provide the necessary operating capital needed to hire and train new staff, for capital expense loans to purchase new equipment needed to take on bigger projects, and we're planning to apply for the SBA 8(a) business development program as soon as possible, but all of these are contingent on being able to provide our finalized 2022 taxes, which remain stalled. The indirect costs of these delays are difficult to quantify, but they are significant.

In all of these instances, it is clear to me that the IRS lacks adequate funding for taxpayer services. Clear and timely refunds and guidance so that taxpayers can finalize our returns on time and accurately budget for future tax payments is critical. This is especially true for small businesses like mine that are investing in risky and expensive R&D, which the Federal Government has otherwise dedicated so many resources to supporting, such as SBIR. I commend our elected officials for reauthorizing the SBIR program, and I would love to be able to take advantage of other existing programs to support small businesses, such as the 8(a) business development program. I need the IRS to be a fully functional agency first, before that is a possibility. I appreciate your attention to this urgent matter, before it is too late for my business and so many others.

Thank you.

PREPARED STATEMENT OF HON. MIKE CRAPO,
A U.S. SENATOR FROM IDAHO

Thank you, Chairman Wyden and Chairman Cardin, for holding this roundtable.

And a big "thank you" to Ms. Camarillo, who flew out from Idaho to join us today. Stephanie and I go back a long way—she actually served as a Senate page for me when I was in the Idaho State Senate. She's had a big impact on the small business landscape in Idaho, and I am eager to hear her perspective today.

Small businesses drive our economy and are particularly essential to Idaho's economy. More than 99 percent of Idaho's businesses are small businesses, employing over 347,000 Idahoans and spurring local innovation.

Unfortunately, despite all that small businesses do for the American economy, the Federal Government does not always return the favor in kind. Too often, the impact on small businesses is not properly evaluated before misguided government policies are enacted.

The financial burden of increased taxes and compliance costs resulting from a complicated tax system and regulatory environment makes it hard for small businesses to make sound financial decisions. When coupled with uncertainty about future tax policy changes and Internal Revenue Service enforcement, those decisions become nearly impossible.

According to the latest National Federation of Independent Business (NFIB) annual tax survey, nearly two-thirds of small business owners reported that the administrative burden of the Federal tax code is significant. Further, 90 percent of small business respondents hired an outside tax professional to prepare and submit their tax returns. "Compliance" and "complexity" were determined to be the leading factors in a small business's decision to hire a tax professional.

While the amount due is not the only tax concern, American small businesses and workers continue to face elevated inflation, as well as workforce and supply-chain challenges. Therefore, it is critical that our tax system promotes U.S. jobs, U.S. manufacturing, and higher wages for hardworking families.

Pro-growth policies in Republicans' 2017 tax law led to one of the strongest economies in decades: low unemployment, a low poverty rate, strong wage growth, high median incomes, increased investment, and record Federal tax revenues. To give small businesses certainty and incentive to grow and compete in the domestic and international economies, we should preserve these policies and explore additional

opportunities to promote growth, increase investment, and encourage research and development in the United States.

We need to get the government out of the way of the small business engine of our economy. Removing the disincentive of complex and high taxes and costly regulations will allow small businesses to go out and do what they do best: create jobs and growth in the economy by providing valuable goods and services to their customers.

Thank you to all of the witnesses participating today. I look forward to hearing from all of you.

PREPARED STATEMENT OF ROGER HARRIS, PRESIDENT, PADGETT BUSINESS SERVICES

Chairman Wyden, Ranking Member Crapo, Chairman Cardin, Senator Young, and members of both the Senate Finance Committee and Senate Committee on Small Business and Entrepreneurship, thank you for the opportunity to testify today on the struggles that small businesses face when it comes to tax complexity.

My name is Roger Harris, and I am the president of Padgett Business Services based in Athens, GA.

Padgett is a national accounting, advisory, and tax preparation company with approximately 200 offices across the U.S. that has served tens of thousands of small business clients for over 50 years. Prior to becoming president of Padgett in 1992, I ran one of the largest Padgett franchises with the company for 10 years. I have long been passionate about the intersection of small business and taxation.

I had the honor of serving as chairman of the Internal Revenue Service Advisory Council (IRSAC) in 2002 and 2003 and always welcome the opportunity to provide feedback to Congress on how to improve our tax system for small businesses. Throughout the pandemic, we saw firsthand the positive impacts that many of the legislative changes had on small businesses and other taxpayers as well as some of the unintended consequences of those policies.

I want to thank both of the committees for putting together this hearing and for all the work you have done and continue to do on behalf of small businesses and taxpayers. I also want to acknowledge the thousands of small businesses that Padgett has worked with over the years for their hard work and invaluable contributions to the economy.

Our daily work at Padgett is primarily with what would be considered "mom and pop" small businesses. Our clients on average have less than 20 employees and come from a wide range of industries. According the SBA's Office of Advocacy, there are currently over 5.4 million businesses with between 1 and 19 employees. Individually they are small, but collectively they represent a major portion of our economy and jobs. There are 61.7 million small business employees in the U.S., comprising of over 46 percent of U.S. employees.[1]

Small business owners get into business to do the one thing they love and the 99 things they hate. Dealing with the complexity of our tax system often ranks high on that list of 99.

I do think there are steps that can be taken by Congress, by the SBA, and by the IRS that can help alleviate some of that complexity and better meet small businesses where they are.

ROLE OF THE SBA

First, the SBA is a huge resource that we must continue to utilize and leverage when it comes to communicating with small businesses. While the SBA and its resource partners cannot replace the role of accountants and trusted tax advisors, they can play a prominent role in getting tax information out to small businesses that is both timely and easy to understand. Whether a business is just forming or is trying to survive a challenging time, the Small Business Development Centers, Women's Business Centers, SCORE Business Mentors, and Veteran Business Outreach Centers can provide invaluable counseling to small businesses free of charge. They have a unique ability to meet businesses where they are and speak their language. Often, when the IRS releases changes or requirements on small businesses,

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[1] *https://advocacy.sba.gov/wp-content/uploads/2022/08/Small-Business-Economic-Profile-US.pdf.*

it is written in a way that is difficult for small business owners to understand. I believe SBA's resource partners could play an even more robust role in delivering information on tax changes and opportunities to small businesses in a concise and comprehensible way.

The Office of Advocacy at the SBA also plays a key role in making sure proposed regulations coming out of the IRS and Treasury fully consider the impact on small businesses. SBA's Office of Advocacy has an attorney specifically assigned to monitor tax regulations and help ensure the IRS and Treasury are considering potential flexibilities for small businesses during the rulemaking process. SBA's Office of Advocacy can and should continue to play an important role in preventing unnecessary regulatory burden and complexity on small businesses by helping to stop it before it happens.

ROLE OF TAX PROFESSIONALS

Most small businesses rely heavily on a tax professional or outside advisor to help them navigate their taxes. However, our tax administration system does not always make it easy for tax professionals to represent small businesses. There are not adequate digital tools at the IRS for tax professionals representing small businesses and getting a power of attorney or other authorization on file can be a long and time-consuming process. The IRS must prioritize upgrading their systems and building more tools for tax professionals, which in turn will have an outsized impact on small business as they navigate the tax system. I have long advocated that there needs to be adequate funding at the IRS for technology and customer service.

One area where Congress could help is giving the IRS the authority to regulate tax preparers. Currently, anyone can hold themselves out as a tax preparer and charge for their services. This often leads to unqualified individuals making mistakes and harming the small businesses that hire them. There must be more oversight to ensure a basic level of competence and ethical standards among those preparing taxes for businesses and individuals. I appreciate proposed legislation in the past by Chairman Cardin and others to address this issue.

There is often no difference between ill intent and ignorance when it comes to taxes—they both can have the same negative result on the government and the taxpayer.

TAX COMPLEXITY FOR SMALL BUSINESSES

With today's tax code, it is easy to stress the need for simplicity, but the process of making that a reality is far from easy. Nobody complains about complexity in the tax code when it saves them money, they only complain when it costs them money. That said, the more Congress and the IRS can support and allow cash basis accounting for small businesses, the more straightforward taxes will be for them. I applaud the change that was made in the Tax Cuts and Jobs Act that allows businesses with average annual gross receipts of $25 million or less to use the cash method of accounting, sparing many small businesses from having to comply with a variety of burdensome requirements. The one record that all businesses understand is their checkbook. They know things are going well when their checkbook is going up and bad when it is going down. The more the tax code can follow that method of understanding the simpler it will be for small businesses.

Despite the fact that most small business owners pay their taxes on their individual return, another important issue for small businesses involves the choice of business structure. Decisions on how to organize, whether as a sole proprietorship, partnership, corporation, S corporation, or Limited Liability Company (LLC), all impact the complexity a small business will have to navigate. Nevertheless, these are often choices that small businesses can leverage for their own unique advantages, but they must be informed and receive good advice. I think this is one area where SBA's resource partners can play an important role in advising new businesses.

In addressing tax complexity for small businesses, however, I think the most important thing for policymakers is learning from past actions and examining what worked well and what did not. For example, with policies that were implemented during COVID–19, there are innumerable lessons to be learned as we contemplate future policy changes. It is important to get all of the stakeholders at the table to examine if there are choices we would make differently next time. The Employee Retention Tax Credit (ERTC) is an example of a small business tax policy with tremendous upsides and challenges that would be well-suited for a thorough analysis to help inform future policy. Ideally, we could get to a place where the IRS does not just get better at solving problems, but gets better at preventing them.

In closing, I think this hearing today is a step in the right direction. I applaud the committees for hosting it and was honored to participate along with these accomplished small business owners.

PREPARED STATEMENT OF MICHAEL NORRIS, PRESIDENT AND CEO, WARRANT TECHNOLOGIES, LLC

I'd like to begin by thanking you for this opportunity to speak today on behalf of Warrant Technologies.

Warrant Technologies LLC is a veteran-owned small business focused on system and software engineering. Founded in 2013, we are headquartered in Bloomington, IN, and have 3 owning partners. We have employees in seven States totaling over 50 system and software engineers, logisticians, and instructional designers. We are CMMI Software Development Level III-accredited, we are CMMC-compliant with SPRS score of 110, hold a Top-Secret Facility Clearance, and have a DCAA Approved Accounting System. We have made use of code sections 174 and 41 expenses and credits from 2018 through 2022.

Warrant is a partner to our DoD customers and a provider in support of our men and women in uniform. We are proud of to play an active role in our Nation's defense. Warrant is considered a successful small business ("SB")—we've grown from a company of one employee to a company of 50+ employees and are projected to continue this trend.

SBs reinvest their dollars on improvements in process and tools, product development, developing technologies, improving infrastructure, attaining compliance with required standards, marketing, and hiring corporate leaders and managers such as CFO, COO, CIO, HR, FSO, IT, CPA, lawyers, consultants—all at indirect cost captured under overhead, G&A, or R&D.

With the dollars we reinvested as an SB, we developed our business in the following ways:

- Employed 11 interns in 2022.
- Competed for work opportunities.
- Hired legal and financial consultants (lawyers, CPAs, etc.).
- Sent six personnel through advanced training.
- Bought operational tools, furniture, software.
- Leased office space, paid utilities.
- Insurances.
- Benefits.
- Hired two new corporate officers to manage growth.

You may think—well, those are just the cost of doing business—and you'd be right. Each of these costs are a critical part of doing business and they contribute to our economy. At this point in our life cycle, I conservatively estimate Warrant needs to find an additional $500K this year to meet growing critical cost of doing business needs.

To effectively manage our continued growth, we project that we need:

- CMMC Accreditation: Cyber compliance with NIST 800. A government mandate and for good reason but its cost is absorbed by the company—estimated cost $50–$150K.
- CMMI Accreditation: Software development government (NAVSEA)-endorsed standard giving evidence of a business' ability to meet DoD software design and development needs—estimated cost $75K to $150K.
- Corporate Office: Hire a contracts officer, human resource officer, financial analyst, receptionist, and a recruiter—estimated cost $400K.
- Training: On new tools and equipment—estimated cost $80K.

With the dollars we reinvested as a SB, we conducted R&D of new technologies and product development (one recognized by NASA), we purchased lab equipment, improved processes, and infrastructure. All of this resulted in the creation of a new company, Thinker Labs LLC.

As of December 31, 2021, expensing of R&D cost under section 174, R&D credits under section 41, and the 20-percent pass-through are no longer permitted. These must now be amortized over 5 years.

Example: The impact on a small business with a net income of $2.5 million dollars, in the 21-percent tax bracket is that in the first year their annual tax burden goes from $315K to $504K—an increase of 38 percent. This $189K-dollar difference represents a high-risk and high-impact scenario for any SB—an error in this case would mean getting a bill some years later for $189K in back taxes, interest, and penalties—just for this first year.

If these tax changes persist, the impact on small businesses, like Warrant Technologies, could be devastating. As a small business, I project our ability to do the following is either severely diminished or all together lost.

- Unable to meet growth and growing cost of doing business needs.
- Unable to invest in R&D.
- Outyear audits will result SB finding their expenses disallowed, and owing penalties and payback of expenses not amortized. This will result in the demise of many small businesses.

I know these committees recognize the value our small businesses play in our Nation's and local economies, our Nation's defense, and our ability to continue to outpace our advisories in technological development. The involvement of small businesses in R&D efforts should be incentivized and rewarded through programs like Small Business Innovation Research (SBIR), Small Business Technology Transfer (STTR), and legislation like S. 1739, the Small Business Innovation Voucher Act.

Fixing the tax burdens that start this year is in the interest of every small business, our Nation's economic growth, and the ability of our small business to continue thrive and pursue research and development efforts. Adoption of the American Innovation and Jobs Act (S. 866) repeals this change and incentivizes small business growth and participation in R&D.

I thank the Finance Committee and the Small Business Committee for their willingness to hear Warrant's statement and act on behalf of the interest of small business. In particular, I thank Senator Young for his active leadership in support of the American Innovation and Jobs Act (S. 866) and his unwavering support of Indiana small businesses.

PREPARED STATEMENT OF HON. RON WYDEN,
A U.S. SENATOR FROM OREGON

Let me welcome everybody to this morning's roundtable jointly hosted by the Finance and Small Business and Entrepreneurship Committees. I also want to recognize Chairman Cardin, also an invaluable member of the Finance Committee, whose idea it was to bring our two committees together to discuss how small businesses could benefit from smart improvements to our tax system. I want to begin with the big improvements to IRS customer service.

One of the key goals of the Inflation Reduction Act was improving customer service at the IRS, which had been clobbered by a decade of Republican budget cuts. That investment has already paid big returns. The phone call response rate went from 10 or 15 percent over the last few years up to almost 90 percent in this most recent filing season. Wait times dropped to just a few minutes. IRS staff worked through the entire backlog of error-free individual returns, which includes returns from small businesses set up as pass-throughs. The IRS has taken important steps to prevent future backlogs and make it easier for taxpayers to resolve issues online.

Taken together, all these improvements should help to prevent a lot of headaches and reduce the audit rate for small business owners. A fully funded IRS also helps prevent tax scams, something I expect we'll hear more about today. I've also been a long proponent of regulating preparers to root out scammers making money off honest small businesses.

Unfortunately, Republicans want to repeal the funding that has made these improvements possible. Just last week, Speaker McCarthy made clear that the $20-billion IRS funding cut in the default agreement isn't enough. He wants to eliminate it all. That would be a major setback for small business taxpayers who deserve a functional IRS.

Second issue: Democrats want to make sure small businesses and typical American families get a fair shake with any tax changes. Republicans want to lock in tax breaks for businesses. That includes the pass-through deduction they passed in

the 2017 Trump tax law—a provision they claim was designed to benefit small businesses.

The nonpartisan Joint Committee on Taxation did the math, and the reality is, most of the benefits of the pass-through deduction are going to the top. In 2019, fully half of the benefits went to individuals who earned $820,000 or more. That's less than 1 percent of the country.

Nobody wants to penalize success, but when the American people hear that Congress is debating tax cuts for small businesses, I don't think they envision huge benefits going to real estate moguls or Wall Street investment firms. In my view, the Congress ought to do a better job of targeting those tax cuts to the real small businesses that power our economy—local shops and restaurants, garages, and small manufacturers, for example.

Finally, I expect the tax incentive for R&D to be a big part of today's discussion. That incentive has support on both sides, and everybody knew that full expensing for R&D was set to expire at the end of last year.

With the expiration date approaching, Democrats told Republicans we'd support extending it as long as Congress also passed tax cuts for working families. That had been the bipartisan approach on expiring tax provisions going back several years. It's also a good deal for a lot of small business owners who benefit from both R&D expensing and the Child Tax Credit. Republicans, however, refused to negotiate any agreement that involved the CTC. It's my hope the Congress is able to break the logjam on these issues in order to help families and small businesses to get ahead.

So, there's a lot to talk about today, including those issues and many more. I want to thank all the participants for joining us this morning, and I look forward to our discussion.

COMMUNICATIONS

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Background

This statement is submitted to the record of the June 7, 2023, roundtable entitled: "Tackling Tax Complexity: The Small Business Perspective." The American Rental Association (ARA) represents the equipment and event rental industry. ARA's 5,600 members operate approximately 12,000 locations throughout the United States with locations in every State and Congressional district. ARA members buy equipment used in construction and related activities as well as equipment used for staging events large and small. The vast majority of ARA members are small independent businesses with less than $30 million in annual revenues, and a majority of those have revenues of less than $5 million. Moreover, most ARA members are organized as pass-through entities.

ARA members rent the equipment in their inventories to other businesses and to the public. ARA estimates that equipment rental companies own approximately 55 percent of the construction equipment in the U.S. on a value basis. In 2023, the equipment and event rental industry will generate about $60 billion in aggregate revenues in the U.S. Approximately 90 percent of those revenues will come from the rental of construction equipment and tools used in the construction industry as well as by small contractors and homeowners. Two general statements about the equipment and event rental industry are (1) the industry is very capital intensive, and (2) equipment and event rental companies are constantly turning over their inventories; retiring older equipment and replacing it with new equipment.

Equipment and event rental businesses can be characterized using the concepts of stocks and flows. The inventory (fleet) is the stock of equipment owned by the company. There is a constant flow of equipment in and out of the fleet as old equipment is retired and new equipment is added to the fleet. When flows of assets into the fleet are greater than the flow of assets out of the fleet, the asset base is expanding. When the opposite occurs, the fleet contracts. Over the past fifteen years, from the beginning of the financial crisis through the COVID pandemic, the equipment and event rental industry has experienced cycles of significant fleet expansions and contractions.

Annual fleet turnover is necessary because rental equipment experiences high levels of utilization. It is not uncommon for some assets to be on rent for more than 60 percent of the time. When equipment is brought back to the rental business it must be cleaned and maintained to get it ready for its next rental. Managing an equipment or event rental inventory is complex and a large part of this is related to financial management.

Bonus Depreciation/Full Expensing

For more than twenty years, Congress has enacted provisions in the tax code that created incentives for businesses to increase capital expenditures that stimulate economic growth. This is one of the reasons the equipment and event rental industry has essentially tripled in size since 2000. Another reason is the growing cost of owning and maintaining equipment that is underutilized by a single owner.

Tax incentives that have helped small equipment and event rental businesses expand their fleets are Section 179 and Bonus Depreciation provisions in Section 168. In 2017 the Tax Cuts and Jobs Act of 2017 (TCJA) made Section 179 permanent

and indexed for inflation. In 2022, businesses using Section 179 could expense up to $1,080,000 if their aggregate investment in qualified equipment was less than $2,700,000. Once the $2,700,000 limit is reached, the allowable expensing under Section 179 is reduced dollar-for-dollar. Any amount of expenditures between $1,080,000 and $2,700,000 could be fully expensed using the 100% bonus depreciation available in tax year 2022. The combination of Section 179 and 100% Bonus Depreciation has meant that since 2017, capital intensive businesses like equipment and event rental businesses have been able to fully expense all of their equipment purchases in fleets with very dynamic asset flows.

Another factor affecting the equipment and event rental industry is the significant inflation in equipment costs and the residual value of these assets on the secondary market. Price increases by as much as 60 percent for some pieces of equipment over the last few years, and the already high cost of owning and maintaining this equipment has significantly increased capital outlays for the equipment and event rental industry. With investment rates equal to about 25 percent of industry revenues, these price increases for equipment have driven revenues higher because increasing costs have driven rental rates higher. As revenues have increased, and the cost of owning and maintaining these assets has increased, the demand for equipment has also continued to grow because of the economic environment created by increases in infrastructure spending as well as renewed spending on events following the COVID pandemic. The result is that many small businesses that were strictly covered by Section 179 are now being pushed into a situation where they need both Section 179 and Bonus Depreciation if they choose to fully expense their equipment purchases. Inflated equipment prices mean other ARA members that are small family-owned enterprises are now exceeding the limits of Section 179 and can only use Bonus Depreciation. Still other equipment rental companies that are defined as small businesses according to the Small Business Administration size standards have only been able to use Bonus Depreciation for the past 20-year period. In 2022, the size standard for an equipment rental business classified as NAICS 532412 (construction equipment rental) was $40 million in annual revenues.

Under TCJA, Section 168 Bonus Depreciation was set at 100 percent from 2017 through 2022. Beginning in 2023, Bonus Depreciation is reduced to 80 percent with additional 20 percent reductions in 2024, 2025, and 2026, respectively. If these reductions in Bonus Depreciation are allowed to take effect, equipment and event rental companies will face a two-edged sword. First, as retired equipment flows out of the fleet and into the secondary market, the proceeds from those sales will be subject to capital gains taxes which will be significant because the assets have a tax basis of zero and used equipment prices are relatively high. At the same time, new equipment is being purchased to replace equipment that has been retired and this new equipment cannot be fully expensed. Thus, the capital gains liability created by the sale of retired assets will not be offset by a tax write-off created by expensing the newly acquired assets. The aggregate result will be the creation of a fiscal drag on the economy because businesses either must curtail their purchases of new equipment or incur debt to pay the capital gains taxes that are no longer offset by expensing their purchases of new equipment. Moreover, if the current provisions of TCJA go unchanged, the signal to small, capital-intensive businesses is do not grow too much or you will fall off a tax cliff that could have long term consequences for the business.

We note that this is not only true for small businesses, but for all equipment and event rental businesses going forward. However, it will make small equipment and event rental businesses less competitive vis-à-vis their larger competitors because smaller firms do not have the financial resources or flexibility that are characteristic of larger firms. In addition, Section 1031 for like-kind-exchanges that allowed businesses to forgo capital gains taxes on exchanges of like-kind assets was eliminated for business personal property in TCJA. For this reason, the American Rental Association supports a permanent extension of the 100-percent expensing provisions of TCJA.

Section 199(A)

TCJA lowered the corporate tax rate from 35 percent to 21 percent. In an effort to maintain tax rate parity between small and large businesses the TCJA created Section 199(A). This provision allows businesses that are organized as pass-through entities to have a portion of their income taxed at a rate significantly less than the ordinary individual tax rate. This has allowed small pass-through businesses in the equipment and event rental industry to remain competitive relative to their larger competitors with a traditional corporate structure.

We believe Section 199(A) has been successful in maintaining robust competition within the equipment and event rental industry. However, under TCJA, Section 199(A) will expire in 2025 and every small business using the deductions allowed in Section 199(A) will be subjected to a massive tax increase. The result will be significantly less competition in the equipment and event rental industry because small businesses in the industry will be paying more in taxes instead of buying more equipment and hiring more employees. In the aggregate, the expiration of Section 199(A) will create an additional fiscal drag on the economy causing economic contraction and increases in unemployment. These costs will be primarily borne by small businesses and their employees but will ultimately ripple through the economy with negative impacts.

Conclusions

The equipment and event rental industry is a textbook example of a competitive industry. There are many firms participating in the industry and barriers to entry are relatively low. While there are large corporations in the industry, small firms still generate a significant amount of industry revenues. Moreover, the industry is decentralized because markets are local in cities and towns large and small across the U.S. The TCJA created a tax environment that has allowed the equipment and event rental industry to grow as the demand for equipment has increased and as the "sharing economy" has become prevalent throughout the U.S. economy. If Congress does not act and 100 percent Bonus Depreciation and Section 199(A) are allowed to expire there will be a significant and negative impact of the equipment and event rental industry in particular, but also on the entire U.S. economy. That is why the American Rental Association fully supports the permanent extension of 100 percent Bonus Depreciation and Section 199(A).

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Statement of Michael G. Bindner

Chairman Wyden and Ranking Member Crapo and Chairman Cardin and Ranking Member Ernst, thank you for the opportunity to submit these comments for the record.

The first question to consider is how is a small business defined? The Small Business Administration standard is 500 employees or less. Of the 33.2 million small businesses, Twenty-seven million are sole proprietorships with no employees.

According to the NAICS Association, there are more than 18 million firms with employees. Thirteen million of these have between one and four. Three million have between 5 and 49 (or 16 million from 1 to 49—or 43 million businesses counting sole proprietors). There are about 276 thousand firms with between 50 and 500 and 43 thousand with over 500 employees.

What kind of businesses exist in the sole-proprietor/small business community? Sole proprietors include hobbyists who do home-based sales or small book volume publishing (I am the latter), gig workers and consultants. There are two types of consultants or gig workers. One kind takes small or large contracts from a variety of sources. The other kind is tied to a single client or gig platform. These employees have a job by any other name.

Small businesses fall along the same lines. Some are simply open for business and have the power to negotiate each contract. Others exist in a franchise system—such as a car dealership or fast food chain—or a single supplier—for example, Monsanto.

The key question for both enterprises is how tax and economic policy interacts with the well-being of these business owners and their employees. Any tax reform should help small firms and consultants which are not captive of a larger firm continue to do business, while ending the incentives that larger businesses use to exploit workers and business owners who are essentially employees, but without the benefits of employment.

We have several concerns (we being both the Center and those who work in the small business sector): minimum wages, benefits—especially healthcare and childcare, family support for both owners and employees, union rights, equal employment and business opportunity, costs of tax compliance and the ability to exit a bad job or contract.

Minimum wage, benefit and family support are best served with some form of government action. This stops bad actors from undercutting those who would do the right thing by their families.

Benefits (both health and childcare) and family support are currently provided through a confusing patchwork of programs, from the Earned Income Tax Credit, Child and Dependent Care Credit and Child Tax Credit to the Affordable Care Act and health insurance exclusion to corporate income taxes. We can do better (this time we are the policy community, both in and out of government and Congress).

Please see the attachment for our current tax reform proposals. We propose that benefits and family support be provided as an offset to a subtraction value-added (or net business receipts) tax with offsets for these benefits.

The average firm should mostly break even—paying out most of what would otherwise be paid in tax and then supporting a bureaucracy to administer both tax benefits and government programs. This is where our proposal is better than the Fair Tax (or should hijack the term)—as the Fair Tax requires government infrastructure and underperforms in distributing income (and thus reducing the need for abortions).

These reforms will change some of the calculus behind whether a larger enterprise abuses employees (both 1099 and franchise) by shedding them from the enterprise (often illegally) or brings them on as full-time employees in order to claim the tax advantages of doing so.

If tax rates are high enough and benefits generous enough, this may move some firms to end their battle with organized labor and their practice of shunting managers of color to franchisee or subcontractor status. A related reform would be to reduce small business contracting requirements as long as fair opportunity exists in the prime contracting firm (for example, hiring and promotion of all qualified workers by random selection).

The tax compliance questions boil down to how complicated tax forms and transaction reporting are in comparison to the current regime. For some small businesses, little can be done to improve things without automation—however most firms with any kind of revenue likely already use advanced data processing.

These tools can be designed to output data files, such as value-added tax paid for the proposed (credit) invoice goods and services tax and family support payment information which would be provided to prevent fraudulent reporting by both workers and employers. The vast majority of employees in both small and large businesses would no longer be required to file individual income taxes (those employees or shareholders receiving less than $500,000 per year).

Capital gains taxes and estate taxes would be replaced by an asset value-added tax, while graduated income tax payments from 6.5% to 26% would be paid by employers as a surtax to their subtract VAT filing.

The asset VAT would expand benefits for selling assets to employee-owned firms to public stock sales (rather than limiting them to private corporations), thus encouraging more employee-ownership. Employee-owned firms can expand their operations to pull in franchise holders and farmers who are reduced to virtual peonage, thus ending their bondage. Our proposed no-fault unemployment reforms would also help workers to leave bad jobs.

Thank you for this opportunity to share these ideas with the committee. Although this hearing was from a week ago, it is being submitted on the same day as the next hearing of this series—Anti-Poverty and Family Support Provisions in the Tax Code. Our comments to that hearing have been submitted already under different cover. As always, we are available to meet with members and staff or to provide direct testimony on any topic you wish. Please contact us through the email above to make this happen, as we have much to discuss.

Attachment—Tax Reform, Center for Fiscal Equity, March 24, 2023

Synergy: The President's Budget for 2024 proposes a 25% minimum tax on high incomes. Because most high income households make their money on capital gains, rather than salaries, an asset value-added tax replacing capital gains taxes (both long and short term) would be set to that rate. The top rate for a subtraction VAT surtax on high incomes (wages, dividends and interest paid) would be set to 25%, as would the top rate for income surtaxes paid by very high income earners. Surtaxes collected by businesses would begin for any individual payee receiving $75,000 from any source at a 6.25% rate and top out at 25% at all such income over

$375,000. At $450,000, individuals would pay an additional 6.25% on the next $75,000 with brackets increasing until a top rate of 25% on income over $750,000. This structure assures that no one games the system by changing how income is earned to lower their tax burden.

Individual payroll taxes. A floor of $20,000 would be instituted for paying these taxes, with a ceiling of $75,000. This lower ceiling reduces the amount of benefits received in retirement for higher-income individuals. The logic of the $20,000 floor reflects full time work at a $10 per hour minimum wage offered by the Republican caucus in response to proposals for a $15 wage. The majority needs to take the deal. Doing so in relation to a floor on contributions makes adopting the minimum wage germane in the Senate for purposes of Reconciliation. The rate would be set at 6.25%.

Employer payroll taxes. Unless taxes are diverted to a personal retirement account holding voting and preferred stock in the employer, the employer levy would be replaced by a goods and receipts tax of 6.25%. Every worker who meets a minimum hour threshold would be credited for having paid into the system, regardless of wage level. All employees would be credited on an equal dollar basis, rather than as a match to their individual payroll tax. The tax rate would be adjusted to assure adequacy of benefits for all program beneficiaries.

High-income Surtaxes. As above, taxes would be collected on all individual income taxes from salaries, income and dividends, which exclude business taxes filed separately, starting at $400,00 per year. This tax will fund net interest on the debt (which will no longer be rolled over into new borrowing), redemption of the Social Security Trust Fund, strategic, sea and non-continental U.S. military deployments, veterans' health benefits as the result of battlefield injuries, including mental health and addiction and eventual debt reduction.

Asset Value-Added Tax (A–VAT). A replacement for capital gains taxes and the estate tax. It will apply to asset sales, exercised options, inherited and gifted assets and the profits from short sales. Tax payments for option exercises, IPOs, inherited, gifted and donated assets will be marked to market, with prior tax payments for that asset eliminated so that the seller gets no benefit from them. In this perspective, it is the owner's increase in value that is taxed. As with any sale of liquid or real assets, sales to a qualified broad-based Employee Stock Ownership Plan will be tax free. These taxes will fund the same spending items as high income and subtraction VAT surtaxes. There will be no requirement to hold assets for a year to use this rate. This also implies that this tax will be levied on all eligible transactions.

The 3.8% ACA–SM tax will be repealed as a separate tax, with health care funding coming through a subtraction value-added tax levied on all employment and other gross profit. The 25% rate is meant to be a permanent compromise, as above. Any changes to this rate would be used to adjust subtraction VAT surtax and high-income surtax rates accordingly. This rate would be negotiated on a world-wide basis to prevent venue seeking for stock trading.

Subtraction Value-Added Tax (S–VAT). Corporate income taxes and collection of business and farm income taxes will be replaced by this tax, which is an employer paid Net Business Receipts Tax. S–VAT is a vehicle for tax benefits, including

- Health insurance or direct care, including veterans' health care for non-battlefield injuries and long-term care.
- Employer paid educational costs in lieu of taxes are provided as either employee-directed contributions to the public or private unionized school of their choice or direct tuition payments for employee children or for workers (including ESL and remedial skills). Wages will be paid to students to meet opportunity costs.
- Most importantly, a refundable child tax credit at median income levels (with inflation adjustments) distributed with pay.

Subsistence-level benefits force the poor into servile labor. Wages and benefits must be high enough to provide justice and human dignity. This allows the ending of state-administered subsidy programs and discourages abortions, and as such enactment must be scored as a must pass in voting rankings by pro-life organizations (and feminist organizations as well). To assure child subsidies are distributed, S–VAT will not be border-adjustable.

As above, S–VAT surtaxes are collected on all income distributed over $75,000, with a beginning rate of 6.25%. replace income tax levies collected on the first surtaxes

in the same range. Some will use corporations to avoid these taxes, but that corporation would then pay all invoice and subtraction VAT payments (which would distribute tax benefits). Distributions from such corporations will be considered salary, not dividends.

Invoice Value-Added Tax (I–VAT). Border-adjustable taxes will appear on purchase invoices. The rate varies according to what is being financed. If Medicare for All does not contain offsets for employers who fund their own medical personnel or for personal retirement accounts, both of which would otherwise be funded by an S–VAT, then they would be funded by the I–VAT to take advantage of border adjustability.

I–VAT forces everyone, from the working poor to the beneficiaries of inherited wealth, to pay taxes and share in the cost of government. As part of enactment, gross wages will be reduced to take into account the shift to S–VAT and I–VAT, however net income will be increased by the same percentage as the I–VAT. Inherited assets will be taxed under A–VAT when sold. Any inherited cash, or funds borrowed against the value of shares, will face the I–VAT when sold or the A–VAT if invested.

I–VAT will fund domestic discretionary spending, equal dollar employer OASI contributions, and non-nuclear, non-deployed military spending, possibly on a regional basis. Regional I–VAT would both require a constitutional amendment to change the requirement that all excises be national and to discourage unnecessary spending, especially when allocated for electoral reasons rather than program needs. The latter could also be funded by the asset VAT (decreasing the rate by from 19.25% to 13%).

Carbon Added Tax (C–AT). A Carbon tax with receipt visibility, which allows comparison shopping based on carbon content, even if it means a more expensive item with lower carbon is purchased. C–AT would also replace fuel taxes. It will fund transportation costs, including mass transit, and research into alternative fuels. This tax would not be border adjustable unless it is in other nations, however in this case the imposition of this tax at the border will be noted, with the U.S. tax applied to the overseas base.

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June 8, 2023

The Honorable Ron Wyden
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The Honorable Mike Crapo
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The Honorable Ben Cardin
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The Honorable Joni Ernst
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Re: "Tackling Tax Complexity: The Small Business Perspective" Joint Roundtable (June 7, 2023)

Dear Chairman Wyden, Ranking Member Crapo, Chairman Cardin, and Ranking Member Ernst,

On behalf of the National Restaurant Association, we appreciate the opportunity to submit comments to the joint roundtable as it evaluates tax code complexity and feedback from Main Street businesses. We urge your support for Main Street restaurant operators struggling with the rising cost of doing business.

The U.S. restaurant and food service industry is comprised of nearly one million outlets with a workforce of more than 15 million employees. The National Restaurant Association ("the Association") is the leading business association for the in-

dustry, and together with 52 state associations, we serve every restaurant through advocacy, education, and food safety programs.

Almost every U.S. county has at least three restaurants, and 9 in 10 restaurants are small businesses. Restaurants are the backbone of their communities, fueling local economic growth, creating jobs, and promoting togetherness. However, most restaurants only see a profit margin of 3 to 5% before tax. Rising food, labor and operating costs cut into these slim margins. Due to the limitation of depreciation and amortization starting in 2022, **restaurant operators are facing a major spike in their tax obligations.**

The Association urges your Committees to advance the AIM Act (S. 1232) to permanently restore the Earnings Before Interest, Tax, Depreciation, and Amortization (EBITDA) calculation method for deducting interest on business debt.

Restaurant operators need the AIM Act to bring back full:

(1) **Depreciation** to help finance renovations, equipment purchases, and expansion; and
(2) **Amortization** to balance loan repayment obligations, some of which will last 30 years.

To remain competitive, restaurant operators must regularly renovate and remodel their dining rooms, kitchens, and buildings. Most operators plan extensive—and expensive—updates every two to three years due to the high activity of dining areas and heavy use of kitchen equipment. During these projects, operators keep a close eye on how these expenses affect cash-on-hand and year-end tax obligations. **Limiting the deduction for depreciation or amortization serves as a tax on investment, especially amid higher interest rates, freezing budgets and creating major long-term complexity.**

Many restaurant operators took on sizeable loans during the COVID–19 pandemic to keep their businesses afloat. The ability to deduct interest on business debt under the previous calculation (which included amortization) is critical to offset the cost of debt financing for businesses. As lawmakers know, small businesses are already struggling to repay loans offered under the EIDL program, and losing amortization worsens their long-term financial prospects.

Without the AIM Act, some restaurant operators will see their overall tax liability rise by nearly 30 percent.

As an industry that prides itself on welcoming all guests, we encourage the Senate to work in a bipartisan fashion to advance the AIM Act. Previous successes, such as the job-saving Employee Retention Tax Credit and the Work Opportunity Tax Credit, improved through bipartisan collaboration. These achievements prove that a divided Congress can still support Main Street economic growth by making commonsense improvements in the tax code, especially those helping family-owned businesses.

Thank you for your consideration. We look forward to working with your Committees.

Sincerely,

Aaron Frazier
Vice President of Public Policy

STATEMENT SUBMITTED BY ANNETTE NELLEN, CPA

Professor of Accounting and Taxation
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Tackling Tax Complexity: The Small Business Perspective

Introduction

I am providing this written testimony for the record of the Roundtable held on June 7, 2023, on tackling tax complexity for small businesses, due to my strong interest

[1] This URL is to a website maintained by Annette Nellen for the purposes of promoting modernization of tax systems and consideration of the principles of good tax policy, with opportunity for readers to post comments at the 21st Century Taxation blog listed at this site. Views represented at this website and blog are Professor Nellen's views only and may not represent those of her employer or professional organizations of which she is a member.

in tax reform. For many years I have researched, discussed, lectured, and written about how tax systems can be improved to reflect how we live and do business today and to follow principles of good tax policy. In addition to being a CPA and attorney in the tax field as well as a professor teaching graduate level tax courses for over 30 years, I am also a sole proprietor. I operate a small business providing materials and instruction for continuing education courses for tax practitioners, and editorial and authoring work for four tax textbooks and other tax materials. Like the majority of sole proprietors, I have no employees.[2]

Complexity is a significant problem for taxpayers. Complexity results from some types of transactions. It also stems from tax compliance systems that do not include the best use of technology or uses technology that is not compatible with other software and technology used in business operations. Finally, a good deal of complexity stems from federal, state, and local tax laws that are often more complex than necessary or that have not considered simpler approaches.

Simplification is an important principle of good tax policy or tax system design. Simple tax laws better enable taxpayers to understand tax systems and comply with them correctly and in cost efficient manners. When tax rules are unduly complex, compliance costs increase. In addition, complexity can cause many taxpayers to not take advantage of provisions that might lower their tax liabilities because they cannot afford the assistance needed to take advantage of these provisions or if the provisions are too complex they might not want to risk any error in claiming them.

Simplicity is closely aligned with the principle of certainty that calls for clear rules that can be followed with high confidence levels that they were followed correctly. Simplicity is also closely aligned with the principle of neutrality that focuses on tax systems serving the primary purpose of raising revenue for government operations and minimizing the number of special rules that serve other purposes.

A simpler tax system supports transparency where taxpayers better understand how tax rules affect them and others. A simpler tax system is better respected by taxpayers and more likely to be followed correctly thereby minimizing the tax gap.[3]

In addition to simplicity and its related tax policy benefits, equity and fairness are also important. Some tax rules relevant to small businesses are not equitable for various reasons. Some tax rules apply more harshly or less favorably to sole proprietors and passthrough entities relative to corporations. Some rules added for simplicity have focused more on the needs of capital-intensive businesses rather than ones where human capital and intangibles are more important. Some changes suggested in my testimony will address both simplification as well as equity, such as where a simplification might also make the tax system more equitable.

My testimony offers suggestions for reducing tax law complexity; several of these suggestions will also make the tax system fairer and more equitable. These suggestions are categorized as follows:

I. Make simplification a focal point in any tax reform activity.

II. Modernize tax rules to better reflect how small businesses operate today.

III. Fix tax rules that are unnecessarily complex.

IV. Implement new approaches to simplify compliance.

V. Promote tax literacy.

I. Make simplification a focal point in any tax reform activity.

In making any tax law change, this question must be addressed:

Is a simpler approach possible?

To answer this, consideration must be given to whether the change requires new recordkeeping by the taxpayer, multiple calculations to identify a best result, whether the taxpayer will need to hire an expert to comply with the rule or take advantage of a tax preference, whether the IRS must issue guidance and if yes whether they are given sufficient time to do so, and whether states are likely to follow the

[2] U.S. Small Business Administration, Office of Advocacy, FAQs, December 2021 reports that 81% of small businesses in the U.S. have no employees; *https://advocacy.sba.gov/wp-content/uploads/2021/12/Small-Business-FAQ-Revised-December-2021.pdf.*

[3] For a listing of various formulations of principles of good tax policy, such as from the AICPA, NCSL and others, *see* Nellen, Policy Approach to Analyzing Tax Systems; *https://www.sjsu.edu/people/annette.nellen/website/PolicyApproachAnalyzingTaxSystems.pdf.*

rule or will taxpayers have different calculations and records for federal and state compliance.

For a small business tax reform roundtable in July 2013, I offered the following suggestions for simplification which are still relevant ten years later:[4]

Simplify! If you cannot describe in a few simple sentences how a rule works or it requires alternative calculations, the rule is not simple and either needs to be revised or repealed.

a. Recognize that for small businesses, simplification may trump accuracy. For example, a standard deduction for home office expenses may be warranted to simplify compliance. Or, tax forms may need to be consolidated, such as is allowed for employers of household employees.
b. Avoid temporary provisions and numerous changes that complicate the tax law and increase compliance costs.
c. Simplify depreciation by expanding Section 179 to a permanent, inflation-adjusted large dollar amount that also covers all intangible assets, such as acquisition of a domain name.
d. Avoid new complexities disguised as small business benefits, such as a deduction for domestic business income of qualified small businesses. Lower tax rates and simplicity are the best tax benefits.
   - 2023 update: With IRC Section 199A, Qualified business income, enacted by the Tax Cuts and Jobs Act of 2017, for 2018 through 2025, a business income deduction exists. In effect, this is a rate reduction but with more complexity than likely would exist with a lower rate structure for an individual's business income. The extension of Section 199A should consider how it can be simplified.
e. Find ways to consolidate duplicative provisions, such as multiple retirement plan options for sole proprietors.
f. Require administrative alternatives to compliance with regulations found to exceed a minimum complexity tolerance level for small businesses.

Another approach to increase the focus on simplification is to obtain comments from tax practitioners who serve small businesses for advice on how any proposal can be simplified.

II. Modernize tax rules to better reflect how small businesses operate today.[5]

a. Allow all businesses to deduct state and local taxes rather than follow a 1944 rule that treats these business income taxes as itemized deductions.

   The Tax Cuts and Jobs Act added a $10,000 "SALT cap" for individuals while corporations have no SALT cap. One rationale for the cap for individuals is that since 1944 when the term "adjusted gross income" was added to the law, state and local taxes that are not imposed directly on a sole proprietor or passthrough entity are viewed as indirect taxes allowed as a deduction from AGI rather than for AGI. For modernization and fairness, individuals should be allowed to determine how much state and local income taxes were paid on business income reported on Form 1040 and deduct that amount for AGI.

   For partnerships and S corporations, this will eliminate the need for elective passthrough entity taxes (PTET) that most states have enacted, as allowed by Notice 2020–75. This will provide a good deal of simplification for the entities and owners, as well as equity for sole proprietors who are not eligible to participate in the state PTET regimes.

b. Modernize and simplify the term "tax shelter" as used at IRC Sections 448 and 461(i).

   Since the Tax Reform Act of 1986, the term tax shelter has been relevant to determine the overall accounting method of certain entities. The Tax Cuts and

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[4] Senate Committee on Small Business and Entrepreneurship, Small Business Tax Reform: Making the Tax Code Work for Entrepreneurs and Startups, July 17, 2013; *see* link to testimony at *https://www.sbc.senate.gov/public/index.cfm/2013/7/small-business-tax-reform-making-the-tax-code-work-for-entrepreneurs-and-startups.*

[5] Several of the modernization and simplification suggestions in this testimony are also listed in a 2019 AICPA position paper: Recommendations for Tax Law Changes to Reflect How Small Businesses Operate in the Modern World, *https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/20190320-tec-small-business-modernization.pdf.* The author of this testimony was one of the drafters of this 2019 position paper.

Jobs Act of 2017 made this term relevant for accounting methods for inventory, capitalization rules, and certain long-term contracts. One way an entity might be a "tax shelter" is meeting the definition of a syndicate as defined at IRC Section 1256(e). This definition pre-dates state law changes that allow the LLC business entity. A business that meets the definition of a "tax shelter" will not be allowed to use simpler accounting methods but instead will be required to use the accrual method, inventory accounting rules, and the uniform capitalization rules of IRC Section 263A.

Today, a small business might be formed as an LLC with financing provided by some owners who will not be involved in running the business. If over 35% of losses are allocated to limited entrepreneurs (inactive owners), the entity is a tax shelter even though it is running a real business (and might just have start-up losses or some bad years). The definition needs to be modernized such as to only be defined as a tax shelter per IRC Section 6662(d) (having a significant purpose of tax avoidance or evasion).

c. Modify or remove rules that operate in conflict with recent simplifications for accounting methods and expensing.

The Tax Cuts and Jobs Act allows most small businesses (other than tax shelters) to use the cash method of accounting, avoid capitalization rules of IRC Section 263A, and expense tangible personal property and software up to $1 million per year (adjusted for inflation) (IRC Section 179). However, if a business acquires intangible assets, such as a customer list or package design, or has IRC Section 195 start-up expenditures greater than $50,000, it will be amortizing these items over 15 years.

Changes should be made to allow expensing of acquired intangibles, and start-up costs under IRC Sections 195, 248 and 709, provided the total outlay for the year is within the IRC Section 179 expensing limitation, adjusted for inflation.

d. Remove the exclusive use requirement for home office deductions.

Modern life makes it unlikely that anyone uses a home office only for business activities. Most people, for example, have a smartphone in their hands and might get a personal call or text message or use a weather app while in their home office.

An alternative would be to allow a home office deduction only if the space is used over 50% for business and to reduce the deduction based on the percentage of personal use of the space, such as based on time. Offering a standard home office deduction, such as allowed by Rev. Proc. 2013–13, would be helpful, with the amount adjusted annually for inflation (and no exclusive use requirement, but adjusting the standard deduction for the percent of personal versus business use of the space based on an average week of use).

e. Increase the $400 threshold for when self-employment taxes start to apply.

The $400 threshold at IRC Section 1402(b) has been in place for decades and is not adjusted for inflation. Today, a self-employed entrepreneur might easily reach this threshold in their first week of business but not yet be ready (or aware) to make estimated tax payments (owed once taxes income and self-employment taxes exceed $1,000). To simplify and reduce the risk of owing penalties for failure to make estimated tax payments, the $400 amount should be increased and adjusted for inflation.

III. Fix tax rules that are unnecessarily complex or inequitable.

a. Restore IRC Section 174 on R&D expenditures to the rules that existed from 1954 to 2021.

In 1954, IRC Section 174 was added to allow research or experimentation expenses to be currently deducted. This is not only an incentive to encourage R&D, but a simplification measure. Without expensing, these expenditures would have to be capitalized and amortized over their useful life (unless a life is provided by statute). Expensing also eliminates the need for taxpayers to determine how much of their indirect expenditures (such as administrative costs) are attributable to R&D activities. Instead, these costs are generally either deductible under IRC Section 174 or Section 162 as ordinary and necessary business expenses.

The Tax Cuts and Jobs Act changed Section 174 for tax years beginning after December 31, 2021 to require R&D expenditures to be capitalized and amortized over 5 years for domestic research and 15 years for foreign research. This adds considerable complexity for businesses of all sizes in identifying all of their R&D costs (particularly indirect G&A type costs) and increases record-keeping requirements.

b. Simplify worker classification rules using a safe harbor checklist.

It is not always easy to determine if a worker, particularly one working part-time or irregular hours, is an employee or a contractor. The IRS should be allowed to create a questionnaire that leads to a result of contractor or employee. Employers who properly use the questionnaire to classify workers cannot be required to amend past filings, but if the IRS determines that the worker is misclassified, any reclassification would be prospective only (assuming the employer honestly answered the questions).

This questionnaire can also remind the employer of the relevant withholding and information reporting rules for the answer reached, with links to the IRS website for further information.

c. Reform "hobby" rules for equity and possible improved compliance.

IRC Section 183, Activities not engaged in for profit, imposes limitations on deductions for activities that generate revenues but not IRC Section 162 deductions. Under this provision, deductions are allowed up to the amount of gross income from the "hobby", with gross income measured as receipts less cost of sales. The allowed deductions though are only deductible if the taxpayer itemizes deductions and are treated as miscellaneous itemized deductions subject to the 2-percent-of-AGI threshold of IRC Section 67. For 2018 through 2025, such deductions are not allowed at all.

IRC Section 183 should be reformed to treat the allowable deductions as deductible for AGI, but still limited to gross income without any carryforward if deductions exceed gross income. The Joint Committee on Taxation defines the "normal structure" of the individual income tax as including deductions for investment and employee business expenses.[6] The logic for this is that these expenses are incurred to generate taxable income and a "normal" income tax would allow such deductions. This argument also justifies allowing a deduction for the reasonable expenses of producing hobby revenues.

Another benefit of reforming IRC Section 183 is that it may reduce the inclination some taxpayers might have to treat a hobby as a business in order to claim the deductions for AGI.

d. Simplify multistate rules involving commerce clause matters.

Businesses of all sizes face a good deal of variation among states as to when they have income or sales tax nexus in the state, or when they must start state income tax withholding for an employee temporarily working in the state.

Congress should continue hearings on these matters and work with states and businesses to develop uniform rules that will provide certainty and simplification to businesses, and likely improved tax compliance for the states.

IV. Implement new approaches to simplify compliance.

a. Make compliance as simple as online banking and buying goods and services online.

As evidenced by many uses of technology today, tax compliance can be simplified via better uses of technology by taxpayers and the IRS. For example, a small business is likely to keep records using software. It is also likely to use a debit/credit card reader for customer payments. It is possible today for most small businesses to have all of their revenue and expenditures recorded and handled electronically. This approach means digital records exist where tax compliance software can use that data to calculate taxes at any moment in time.[7]

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[6] JCT, "Estimates of Federal Tax Expenditures for Fiscal Years 2022–2026," JCX–22–22 (December 22, 2022), page 4; *https://www.jct.gov/publications/2022/jcx-22-22/*.

[7] *See* Nellen, "Let's say 'goodbye' to the April 15 due date," *The Hill,* April 17, 2021; *https://thehill.com/opinion/finance/548831-lets-say-goodbye-to-the-april-15-due-date/*.

Software could also use the appropriate digital data to not only prepare income tax returns, but also information returns such as Form 1099-NEC a business needs to file with the IRS and contractor if paid over $600 during the year.

All efforts should be made including appropriate funding for the IRS and to help small businesses set up efficient digital records to streamline tax compliance.

b. Allow co-owners of a start-up business to elect qualified joint venture status for the first few years.

IRC Section 761(f) allows a married couple to elect to treat a business they jointly own and operate as a "qualified joint venture" rather than as a partnership. The couple files two matching Schedules C rather than a Form 1065 partnership return. This is simpler for the couple and enables both spouses to pay into the Social Security system.

Filing two Schedules C is much easier than filing a partnership return including a Schedule K–1 (as well as Schedule K–3) to each partner.

The qualified joint venture option should be expanded to make it available to equal owners of any business (perhaps limited to two to four equal owners). Schedule C could include a box for making the election. To avoid any concern about disclosure of each owner's SSN to the other owner(s), each owner could be required to obtain an EIN to enable the IRS to confirm that each owner filed an identical Schedule C. Any concern about the need to file as a partnership can be addressed by only allowing qualified joint venture status for the first three years or until gross receipts exceed a certain threshold.

Qualified joint venture status should also be allowed even if the business is formed as an LLC. States should be highly encouraged to conform to this broadened qualified joint venture option to truly provide simplification to small business owners. Also, the ease of this filing compared to filing a partnership return should also improve compliance.

c. Broaden penalty waiver for the first year or two for a small business that has exercised reasonable efforts to comply.

The compliance obligations under federal and state tax laws and other laws a business may be subject to can be overwhelming. While new businesses should take time to learn about these obligations prior to starting their business, it is easy to overlook certain rules or not be aware they don't fully understand them. To encourage compliance and not set a new business back or perhaps put them out of business due to penalties, reasonable cause should be applied broadly to reduce penalties while also providing information and assistance to prevent a repeat of the inactions that led to the penalties. For example, a new business owner might not be aware of the need to file Form 1099–NEC if they pay a contractor $600 or more. Also, in the early years, they might not be able to afford to hire a tax adviser who can help them with all of their tax obligations.

V. Promote tax literacy.

a. When a taxpayer requests an EIN for a new business, the IRS should at that time also send (electronically and/or by the US Post Office) information about tax obligations of a business in a form understandable by a layperson.

b. Provide funding to the IRS and SBA to run live, online workshops for new business owners on specific topics relevant to helping the taxpayer understand their tax obligations and to ask questions.

While there are numerous publications at the IRS website that can help a new business owner understand their tax obligations, they can be overwhelming and sometimes not specific enough such as to explain estimated tax payments and information reporting obligations.

An example of such workshops can be found at the California Department of Tax and Fee Administration (CDTFA) website that cover a multitude of topics such as recordkeeping, navigating the CDTFA website, and ones specific to particular industries.[8] Other states might have similar workshops that are examples of ways to help business owners understand their tax obligations.

[8] CDTFA, Tax Education Events; *https://www.cdtfa.ca.gov/seminar/*.

c. Find ways to promote and fund tax literacy activities.

Any federal funding of financial literacy activities should be sure to include an introduction of federal tax obligations of a new business. STEM activities funded by the government, and similar ventures that reach high school and college students, should also be encouraged or required to offer tax education because many of these students will become self-employed entrepreneurs.

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On behalf of the Small Business and Entrepreneurship Council (SBE Council), thank you hosting the important roundtable on "Tackling Tax Complexity: The Small Business Perspective" and for the opportunity to submit a statement for the record. There is a long list of policy measures that Congress can consider to promote tax code simplicity and certainty for small businesses, which can help to fuel entrepreneurship, innovation, small business growth and a vibrant competitive economy. This statement will focus on immediate expensing for qualified R&D expenditures, and our organization's support for restoring, enhancing and making permanent this important measure. SBE Council supports the bipartisan "American Innovation and Jobs Act" **introduced by Senators Maggie Hassan (D–NH) and Todd Young (R–IN)** in the U.S. Senate, and the bipartisan "American Innovation and R&D Competitiveness Act" **introduced by Representatives Ron Estes (R–KS) and John Larson (D–CT)** in the U.S. House.

As background, SBE Council is an advocacy, research and education organization dedicated to promoting entrepreneurship and protecting small businesses. For nearly 30 years, SBE Council has worked to advance a wide range of policy and private sector initiatives to improve the ecosystem for strong startup activity and small business growth. Our network of more than 100,000 member supporters, including entrepreneurs and small business owners, state and local business organizations, corporate partners and associations work with us to strengthen the environment for entrepreneurship, investment, innovation and job creation. Since our founding in 1994, SBE Council has helped to strengthen the ecosystem for small business and entrepreneurial success not only in the U.S., but across the globe.

Tax Certainty Is Critical During This Period of Time

Inflation and economic uncertainty continue to bear down on small business America. On top of high prices, small firms are enduring labor shortages and higher labor costs, a more difficult time accessing capital, and an economy that remains challenging. That is why Congress must identify practical solutions to help entrepreneurs through this uncertain economic period, and beyond.

Small business owners and their employees across industries have had to continuously innovate in order to survive and thrive over the last several years. While the COVID economy imposed significant burdens and restrictions on small businesses, digital tools and changing consumer needs provided opportunities for innovation and new risk-taking. Many entrepreneurs and new startups tapped into immediate R&D expensing to support innovative investments and business growth.

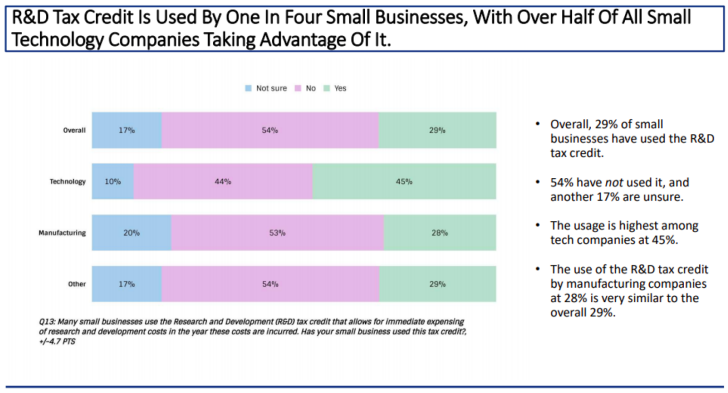
For several decades, American businesses of all sizes have expensed R&D investments in the same year they occurred. This tax measure has helped to fuel hundreds of billions of dollars in R&D investments each year, and by extension has powered U.S. innovative leadership in the global marketplace. The tax credit's value to U.S. economic and technological leadership alone should move Congress to not only restore the credit but improve it so that more startups and new firms can effectively utilize it. The stakes are quite high for this expensing measure.

Failing to restore immediate R&D expensing would put all American businesses—but especially small businesses—at a competitive disadvantage. If not restored, the change in R&D tax credits would require companies to amortize their R&D expenses over five years. That extended timeline significantly limits businesses' ability to develop new products, from medical devices to everyday consumer products. For smaller firms operating on thin margins and in a competitive and challenging environment, the inability to expense R&D costs for a given year means they cannot recover those costs in the same year. This makes it even more difficult for small businesses to effectively compete, invest, and take on bigger risks. Moreover, many small businesses are now looking at an expensive tax bill that threatens the competitiveness and innovative capacity of their firms, and the survival for a surprising number of firms.

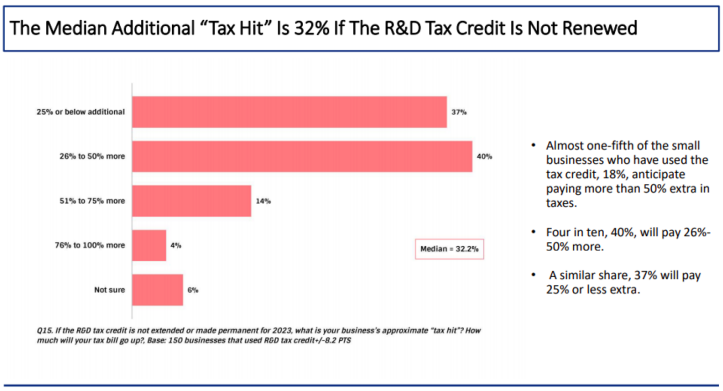
Costly Impact for Small Businesses

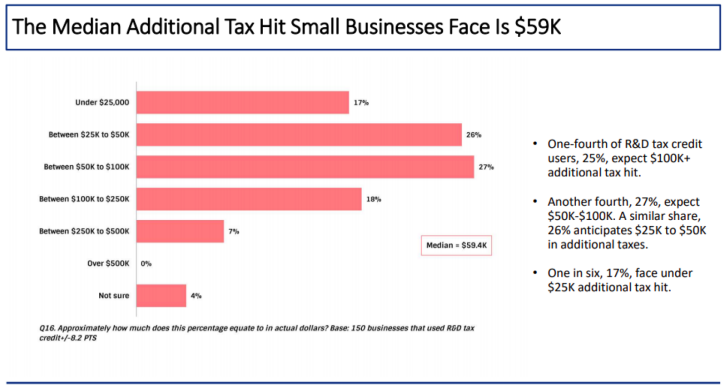
In a new SBE Council/TechnoMetrica survey that was released on June 6—**"Emerging Technology, Innovation and Small Business"**—we specifically explore the small business impact of not restoring immediate R&D expensing. The results reveal harm and damage for our economy, local economies, investment, employees, and to the small businesses who have utilized this tax incentive.

The survey reveals that 29% of the small businesses we surveyed used immediate R&D expensing, and that 72% of those business owners who reported they used it knew that the write off was no longer available. So, for 28% of small business owners who used this tax incentive but were unaware that it is was no longer available, this was shocking news for many.

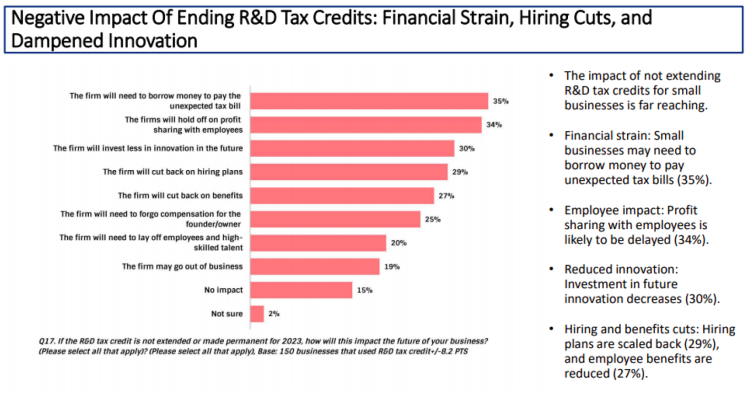


In terms of financial impact, the small business owners we surveyed reported that the new (and unexpected for some) tax burden would be significant (see following two graphs). The median "tax hit" for small businesses is a 32% increase in their tax bill. The median dollar estimate is $59,000. For some firms, the burden is much higher.





The negative effects of ending immediate R&D expensing extends beyond the financial strain on businesses. Indeed, 35% of small business owners report they will need to borrow money to pay the new tax bill, and 19% report that their firm *may go out of business*. Other impacts include: holding off profit sharing for employees, decreased investment in future innovations, scaled-back hiring plans, reduced employee benefits, laying off employees, and forgoing compensation for the owners or founder.



Not surprisingly, small business owners that have utilized immediate R&D expensing overwhelmingly support bipartisan legislation to restore and make it permanent. Approximately 86% of small enterprises support a bill that aims to make immediate expensing of R&D costs a permanent provision, with additional enhancements for small businesses. Only 6% oppose this legislation, while 8% remain unsure.

As an important side note, I would like to add that the firms we surveyed are true small businesses. Of the 461 small businesses surveyed, only 11% are firms with between 51–100 employees. The remainder have 50 employees and fewer. The median number of employees on the payroll of small businesses surveyed was 11.5, and 36% have between 2 and 5 employees. These are the small businesses that drive innovation and local economies. Therefore, a new "tax hit" on the magnitude of between $25,000–$50,000 or more is very significant. It is likely why we see that 19% of the business owners we surveyed report that they may need to close the business due to this new financial burden. We anticipate that many of these businesses will also have a more difficult time accessing the loans that are needed to pay these new tax bills.

Challenging economic forecasts on top of the enduring pain points that have kept small businesses reeling for several years demand a policy response that will promote investment, certainty, and relief. Measures that stand behind and support the innovative practices and investments of American small businesses are especially important now—for boosting the economy, moving to full recovery, and reaffirming America's role as an innovation powerhouse.

Small business owners and their employees need our elected leaders to come together on key issues such as this one. Immediate R&D expensing must be restored, made permanent, and hopefully enhanced without delay. Please let SBE Council how we can help the committee in advancing this important issue, or answering any questions you may have.

Thank you for your consideration in submitting this statement into the official record of this important hearing.

Respectfully,

Karen Kerrigan
President and CEO

