

TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE
NATIONAL FEDERATION OF INDEPENDENT BUSINESS

NFIB
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Testimony of

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before the

Joint Economic Committee

on the subject of

**Small Business, Big Taxes: Are Taxes Holding Back
Small Business Growth?**

on the date of

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Good morning Chairman Coats, Vice Chairwoman Maloney and members of the Joint Economic Committee. Thank you for the opportunity to testify today. I am pleased to be here on behalf of the National Federation of Independent Business (NFIB) as the Committee discusses small business, tax policy and economic growth in the small-business sector. NFIB is the nation's leading small business advocacy organization representing over 350,000 small-business owners across the country. NFIB represents businesses in most industries and of various sizes, with about 80 percent under 40 employees.

The small business economy is slowly emerging from one of the worst recessions in U.S. history. NFIB's monthly Small Business Economic Trends (SBET) survey data shows the dramatic change in consumer spending, employment, owner's confidence and business investments throughout the recession and subsequent recovery¹. While some business activities have made significant improvement over the past four years, capital expenditures and outlook on business conditions and expansion remain at historically low levels due to economic conditions and the political climate. The threat of higher taxes whether in the form of income taxes, the healthcare law, the estate tax, section 179 expensing limits, or others creates enormous uncertainty among small-business owners worried about the impact of policy changes on future business costs.

The SBET survey also tracks which problems most affect owners in operating their small businesses. From mid-2008 through mid-2012, "poor sales" was their number one problem as consumer spending declined sharply. But now "taxes" is often the number one concern for small-business owners, a problem that moderates the economic recovery in the small-business sector.

The NFIB Small Business Problems and Priorities survey highlights three main areas of tax policy that are of great concern to small-business owners². The survey is of a random sample of NFIB members asking them to evaluate 75 potential small-business problems and assess the severity of each. The problems are then ranked by their mean score. With the "Cost of Health Insurance" leading as the most severe problem for small-business owners, five of the top 10 problems are all tax-related. These tax problems fall into three categories: cost, complexity and frequent changes.

The cost of tax obligations is threefold; the amount paid to federal, state and local tax agencies, the cost of hiring a CPA or tax advisor to navigate complex tax codes, and the owner's time in providing the required paperwork and/or filing themselves. Eighty-eight percent of small employers use a tax preparer, and most use one to either ensure compliance or because the requirements are too complex. Tax-related regulations cause the greatest difficulties for 40 percent of small employers, more than environmental, health and safety, or employee-related regulations.³ And compliance costs are especially problematic for small-business owners as they are 67 percent higher for small businesses than for their larger counterparts, costing them \$18-19 billion per year, or about \$74 per hour⁴.

Tax-related costs compete with owners' ability to use limited profits for primary business activities. Profits are the main funding mechanism for owners purchasing new equipment,

¹ Dunkelberg, William C., and Holly Wade, *NFIB Small Business Economic Trends*, NFIB Research Foundation, series.

² Wade, Holly, *Small Business Problems and Priorities*, NFIB Research Foundation, 2012.

³ Dennis, William J., *Tax Complexity and the IRS*, NFIB Research Foundation, Volume 6, Issue 6, 2006.

⁴ <https://www.sba.gov/sites/default/files/advocacy/rs343.pdf>

expanding facilities, hiring and stocking inventory. Tax-related cost pressures are especially problematic for newer firms that almost solely rely on profits for operation and expansion costs as they are generally not able to access traditional lending sources. Banks almost exclusively lend to more established firms, not new ones due to higher failure rates. But regardless of the firm's age, tax burdens take a heavy toll on owners' ability to operate their businesses.

One example that encapsulates all three categories of tax-related problems for small-business owners is the Affordable Care Act (ACA). The employer mandate, small-business tax credit, and the termination of employer reimbursements are just a few of the many tax-related costs and complications small-business owners face in complying with the new law.

The cost of health insurance is the most critical issue facing small-business owners. It is the main reason owners do not offer employer-sponsored health insurance and the main reason owners discontinue providing the benefit⁵. But the employer mandate does not take into consideration the cost issue as it requires all employers with 50 or more full time equivalents to offer health insurance or pay a tax for not offering.

The employer mandate pressures offering firms to continue regardless of profitability and penalizes firms for not offering, regardless of their financial situation. Firms with high employee turnover, seasonal employment and lower profit margins are less likely to offer health insurance. But now, those with 50 or more full time equivalents must absorb an additional tax for not offering, offer increasingly expensive health insurance, or limit employment - all less than optimal options.

The employer mandate also contributes to increased tax complexity due to the often ambiguous and complicated aggregation rules associated with calculating the number of full time equivalent employees. The paperwork associated in calculating employee hours as they relate to the mandate reduces the most valuable asset of the owner, his or her time. And the aggregation rules will be most difficult for owners with seasonal employees, high employee turnover or own more than one employer firm. The IRS estimates that it will take over 4 hours to fill out the required forms, acknowledging that these estimates will vary due to individual circumstances. For firms with more complicated employment structures, the time commitment required will likely be far greater⁶.

Small-business owners have also encountered repeated delays and confusion over the ACA's small-business health insurance tax credit and financial reimbursement options. The tax credit is a targeted approach to help curb health insurance costs for offering small employers and is intended to provide an incentive for those that do not, to start offering. However, the tax credit is largely ineffective on both fronts as its design is exceedingly restrictive, complicated, and only offers temporary relief to a larger small business cost problem. The tax credit now serves as a windfall for the few who qualify and take the time, or pay an accountant, to file for it. The IRS estimates that it will take over 15 hours to understand, complete and submit the appropriate forms⁷. The paperwork costs involved in filing for the tax credit will likely yield little benefit at

⁵ Dennis, William J., *Small Business's Introduction to the Affordable Care Act Part II*, NFIB Research Foundation, December 2014.

⁶ <http://www.irs.gov/pub/irs-pdf/i109495c.pdf>

⁷ <http://www.irs.gov/pub/irs-pdf/i8941.pdf>

the end of the day. These problems are not an uncommon fate for many tax credits including those trying to increase hiring and car sales. Generally these types of incentives only benefit those already committed to the activity and are willing fill out the required paperwork or pay someone to do it for them.

Another ACA tax burden that falls into the frequent changes category is the termination of employer reimbursements for individually purchased health insurance plans by their employees. A recent NFIB survey found that about 18 percent of small employers offered this benefit last year and are now in violation of the law. NFIB continues to receive calls from owners, generally after having talked to their CPA or insurance agent, confused about the new rules prohibiting the practice and the subsequent harsh tax penalties. It is very likely many small employers are still not aware of this change in policy and will be notified of its termination in the form of a letter from the IRS requiring payment of excessive penalties.

The ACA is just one example of how excessive tax burdens affect small-business owners. And the federal tax code is only one layer of tax obligations owners face in operating their business. They must also comply with state and local taxes adding to the overall compliance burden. Unfortunately, only the owner experiences the cumulative effect of all the required taxes and regulations places on their business. Federal, state and local lawmakers and government agencies only see them in isolation, giving a false perception of their true impact. But it's the responsibility of the business owner to manage them all while trying to operate a profitable, successful business.

In conclusion, small-business owners continue to be excessively burdened by direct, indirect, complicated and ever changing taxes related to operating their business. Alleviating the excessive tax burden on small businesses is an essential component in creating a strong, healthy environment for owners to operate and grow their business. I appreciate the opportunity to present NFIB's views and data on the effects of tax policies on small businesses. I look forward to answering any questions you might have.