National Small Business Network

Tax Reform for Economic Growth

Policy Recommendations for the 115th Congress – February 2017

After many years of discussion, the House, the Senate, and the new President appear ready to consider significant tax reforms. With our limited national economic resources, it is vital that we use the tax reform process carefully to stimulate broad, sustainable, economic growth and not just borrow against future generations and increase our national debt. The following tax reform recommendations are made as part of a balanced program of both tax policy and budget policy actions to restore a sustainable Federal fiscal process. The detailed recommendations build on many of the concepts developed by prior House and Senate committees and working groups and other tax reform advisory groups. They focus primarily on business tax reform issues, particularly for small and mid-sized businesses, because those will have the greatest impact on job creation and general economic growth.

Basic Tax System Principles for Sustainable Economic Growth:

- **Simplify and coordinate our overly complex tax code to reduce both taxpayer and IRS administrative expense, and improve compliance.**

- **Make sure that business tax reform provides equitable tax incentives for the growth of small businesses that provide over half of all jobs. These are predominantly pass-through entities which will require separation and equitable treatment of their business income in the personal tax code.**

- **Promote real and sustainable economic growth by providing tax preferences primarily for direct investment in businesses, buildings, and equipment that create new jobs.**

- **Promote long-term investment in new business formation and real property development by correcting the capital gains tax code for long-term inflationary distortions of real gain, and providing better incentives for small business startups.**

- **Promote domestic investment and job creation to the greatest extent possible within the limitations of international agreements by focusing tax preferences on domestic investment and evaluating alternative tax systems to increase international tax equitability, and reduce the ability of multi-national corporations to avoid taxes by shifting profits to lower tax rate countries.**

- **Provide long-term, user based, revenue sources to maintain and improve America's public infrastructure, which is vital to our economic growth.**

- **Assure that any tax reform is revenue neutral and provides adequate overall revenue to gradually reduce our national debt and restore long-term fiscal stability**.

Unfortunately, even after short term stimulus effects, tax reform will need to be somewhat revenue positive overall to reduce the national debt and unfunded future obligations that were authorized, by prior Congresses. Most economists believe that continuing deficits and our growing $18 Trillion national debt will reduce long-term economic growth, and are a very real threat to the future sustainability of our economy. Please see our related recommendations on *Fiscal Reforms for Sustainable Government* on our website at www.NationalSmallBusiness.net.

Background:

Our overall tax level is not the cause of our current economic and under employment problems. The total US average Federal, State, and local tax burden is the forth lowest of all 34 OECD countries at 25.7% of GDP. Only Korea, Chile, and Mexico have lower average rates, and the average of all other OECD countries is 34.1% of GDP. With the exception of payroll taxes, most American businesses pay Federal taxes only when they are profitable. The current federal tax level on individuals and "pass-through" business entities is lower than it was during times of economic prosperity and growth, and is lower than most other leading industrial nations. The stated tax rate on large corporations appears higher than other nations, but when adjusted for US business tax incentives and other taxes imposed by foreign countries, such as value added taxes, it is similar to other leading industrial nations. Even during a time of high corporation earnings, corporation income tax revenues have fallen from 5% of gross domestic product in 1952 to only about 1.9% today. Some of this reduction results from smaller corporations converting to subchapter S corporations and LLCs whose income is reported as personal income. Some of it also results from larger corporations avoiding taxes by shifting taxable income to foreign countries with lower tax rates on net income.

For the past 10 years, most Federal tax rates have been lower than historical averages, particularly on the very wealthy who are receiving an increasing percentage of all income and assets. This is a major cause of our spiraling debt. Lower tax rates, particularly on capital gains and stock dividends have also encouraged financial speculation which was a major cause of the 2008 recession. However, as the last 10 years have proven, lower tax rates did not promote sustainable domestic economic growth.

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1. Tax Expenditure Recommendations

Many tax expenditures were extended for two years or more at the end of the First Session of the 114th Congress, but all tax expenditures and special tax rate provisions should be evaluated at least every 10 years for possible modification or progressive elimination. Pass permanent or multi-year targeted tax incentives such as business deductions, credits, and accelerated write-offs only where they have been proven to effectively support direct domestic business investment and employment. To obtain the best economic return from tax expenditures, always pass them well in advance, and do not waste resources on retroactive incentives.

Tax law, including tax expenditure incentives, can be a major factor in economic decisions by both businesses and individuals. Tax policy is also one of the few remaining strategic tools to provide targeted economic incentives for domestic economic growth. Businesses and investors often focus on short-term profit, rather than on the long-term sustainability of their business; the health of the national economy; or concern for the environment. Tax policies that overly “broaden the base and reduce the rate” would limit the ability of Congress to provide strategic incentives for long-term economic sustainability and international competitiveness.

Flat tax structures tend to encourage short-term speculation instead of long-term direct investment. They also encourage movement of investment capital anywhere in the world where the potential return is highest. Flatter tax brackets primarily benefit wealthier investors, particularly if capital gains are kept at a lower rate. This would result in an increasingly economically segregated national economy, increased unemployment, and lower total tax revenue and would further increase our unsustainable national debt.

Reducing most current tax expenditures in order to reduce maximum tax rates would probably also significantly increase the effective tax burden on middle income and small business taxpayers while reducing tax revenue from large corporations and the very wealthy. Most tax expenditures, including deductions, credits, and preferential tax rates are limited either by specific maximum amounts, or maximum overall income levels for which the provisions apply. These limits are in place to obtain the greatest economic or social policy affect with the least loss of tax revenue, and often have the greatest incentive effect and benefit for middle income taxpayers. Because of the large and growing percentage of total taxable income going to the upper 1% of all citizens, any reduction in the progressivity of personal tax rates on higher incomes will eventually result in an overall reduction in tax revenues and a higher tax burden on middle class taxpayers and small businesses.

Even though some tax expenditures can have high value in stimulating economic activity with long-term benefits, many provide little benefit in relation to their revenue cost, and some are pure “pork” that benefits a small number of businesses or individuals. Existing Congressional data does not provide adequate decision-making data for Congress to accurately evaluate existing tax expenditures, deductions, and rate preferences. We recommend that the House and Senate Budget Committees and Senate Finance and House Ways and Means Committee jointly request the CBO or JCT to develop a current comprehensive analysis of the economic benefits of all tax expenditures.

2. Tax Simplicity, Clarity, Equitability, and Efficiency Recommendations:

One of the key goals of tax reform should be to simplify the complexity of the current code, and provide greater tax system clarity and equitability for different taxpayer entities. The current code, which was built on successive layers of changes by past Congresses, has become too complex with too many adjustments, limitations and phase-outs for taxpayers to understand and comply with. Many provisions either purposely or unintentionally negate or limit the effects of other provisions. Other provisions have become outdated by changes in technology or business practices.

A. Increase the role of the Joint Committee on Taxation, Treasury Tax Policy and the IRS in assisting Members of Congress in the ongoing development of a simpler and better-coordinated federal tax code. Complexity makes it difficult for taxpayers, and even professional tax preparers, to understand and comply with the code. Complexity also increases the administrative burden on the IRS and makes it difficult for them to provide good taxpayer assistance and improve filing accuracy and taxpayer compliance. Often the IRS has to resolve legislative issues with hundreds of pages of detailed regulations which increases the administrative burden on the IRS, and often just further increases complexity for the taxpayer. The Congress should direct JCT, Treasury and the IRS to develop a joint working group to identify existing code issues requiring better legislative clarity or coordination, and a process to develop legislation to resolve them.

B. Revitalize the management and business system reforms of the Internal Revenue Service to provide better taxpayer assistance and an efficient and equitable administration process. The ability of the IRS to properly and efficiently administer the tax code is currently hindered by incomplete improvements to vital business systems such as data processing and communication technology. The IRS is also facing increased administrative responsibilities, such as the ACA and FATCO, combined with declining budget allocations, and heavy turnover of key staff. With budget cuts, training has been reduced and staff expertise has declined. This is resulting in declining levels of performance in many areas and increased burdens on taxpayers and return preparers. The combination of a complex tax code, declining taxpayer assistance, inadequate IRS budgets, and reduced IRS training and staff levels will eventually threaten accurate and equitable enforcement of tax laws. If this happens, it will also reduce collection of the revenue needed for all other Federal programs and services.

Congress and the Administration need to recommit to the goals of the 1998 IRS Reform and Reorganization effort by providing better taxpayer assistance, support for improvements to technology systems, and stronger management emphasis on business process re-engineering for greater efficiency in the tax administration process. Commissioner Koskinen is doing a good job trying to identify and resolve problems with the limited resources of the agency. However, the IRS needs increased Congressional budget support and better proactive communication on agency issues. The Administration and the Senate also need to complete the revitalization of the IRS Oversight Board with additional nominations, to assist IRS management with continuing organizational improvements and communication with the Congress.

C. Provide standard tax code definitions and coordinated inflation adjustments for all limit and rate bracket provisions. Multiple definitions exist for many items of income and types of credits and deductions. These need to be standardized and simplified. Congress needs to review the Internal Revenue Code for fixed limitations and provisions, which are long overdue for inflationary adjustments, such as the business gift limitation, and update them. Then, adopt a standard inflationary adjustment provision to replace the myriad of specific provisions in the code for rate brackets and all dollar limitations which should have periodic adjustment. The provisions should require a reasonable minimum inflation change before a periodic adjustment is made. We also support the tax clarity and simplification recommendations of the American Institute of Certified Public Accounts Tax Policy Committee.

D. Eliminate the Alternative Minimum Tax for all taxpayers with gross incomes under $250,000 and replace all surtaxes and deduction phase-outs with a single, more progressive, tax rate structure on personal Adjusted Gross Income.

The parallel AMT tax system and various surtaxes and limitations on deductions add unneeded complexity and lack of understandability to the tax code. In 2013, Congress made inflation indexing of the personal AMT exemption permanent, but failed to correct many of the underlying issues, that have a major impact on small business owners. Taxpayer Advocate Nina Olson has repeatedly addressed this issue in her annual reports to Congress. She has stated that if the individual AMT is not eliminated, then Congress should "…eliminate personal exemptions, the standard deduction, deductible state and local taxes, and miscellaneous itemized deductions, as adjustment items for Individual Alternative Minimum Tax purposes."

Congress should at least eliminate the burden of AMT calculation for most taxpayers, through a $250,000 safe harbor, and by matching of the more economically significant provisions in the regular tax code with the AMT provisions. The tax code should also provide better equality in the AMT treatment of "Small Business Operating Income" reported on a personal Form 1040 return, with the far higher $5M "C" corporation AMT exemption limit.

E. Remove outdated administrative burdens in the tax code such as the remaining "Listed Property" reporting requirements on standard business computers and communication equipment.

The Small Business Jobs Act of 2010 removed the outdated usage record keeping requirements for employer provided business "cell phones", but failed to remove the equally burdensome and illogical requirements on similar common business communication devices and portable computers. With the merging of cell phones, computers, and cameras into single inexpensive devices, the remaining listed property reporting requirements and deduction limitations for business "computers" when used outside a "qualified office" also need to be removed. As with cell phones, if there is a legitimate business need for a mobile computer, there is usually little or no additional marginal cost for any personal use of the same equipment, because most hardware is replaced long before the end of its potential usable life. The new IRS repair regulations allow a taxpayer to elect to expense replacement items costing less than $5000, for most small businesses, which makes the existing listed property requirements even more illogical.

F. Simplify state income tax nexus issues for out-of-state businesses by adopting a modernized federal limitation on non-nexus state income and business activity taxation, of both services and products. This should include digital products delivered from outside a state via public carriers and electronic transmission by businesses without state nexus. Modern electronic technology has greatly increased the ability of even small businesses to sell both goods and services nationally without any physical nexus in a state. Unfortunately, this increased capability, combined with increased legislative and enforcement activity by revenue starved state governments, is creating significant state income tax nexus problems for businesses.

Complying with out of state income tax or "business activity" tax laws for a small amount of out of state business, often subjects small businesses to significantly higher accounting and tax preparation expenses, and a higher total tax liability. Although states provide some credits for personal income taxes paid to other states, these calculations are complex. States often have filing minimums that can result in the taxpayer paying more total taxes than they would have paid to a single state. Corporate income taxes are often calculated differently by each state, and states usually do not provide any credit for corporate taxes paid to other states. Because of this complexity, many small businesses either ignore out of state income tax filings and risk potential penalties, or reject potential out-of-state business, which restricts interstate commerce. For many service businesses, it is difficult to determine which states have a valid tax nexus with the growth of "cloud computing" and web applications.

The "Commerce Clause" of the Constitution makes the Congress responsible for preventing the states from enacting barriers to interstate commerce. Quick Congressional action can prevent this problem from growing, and reduce a major non-value-added cost on small businesses without any Federal cost.

G. Pass marketplace equitability legislation to protect each state's right to use sales and consumption taxes at the state level, and simplify retailer remittance of interstate consumption taxes.

Congress should support effective and efficient interstate collection of state sales and use taxes, to provide an equitable business environment for those businesses that properly collect state sales taxes, by passing marketplace fairness legislation. A federal interstate sales tax administration law would not create any new taxes, but would simply enable states that have chosen to use consumption-based taxes to efficiently collect them on the growing volume of internet purchases. It is similar in principle to the many agreements the federal government has with states and foreign countries to exchange tax information to help stop tax evasion. Congress should simplify calculation and reporting of sales taxes for interstate sellers by enabling a single, uniform electronic tax reporting and payment processing system.

3. Capital Gains Tax Reform Recommendations:

Congress should encourage long-term capital investment by adjusting the calculation of long-term capital gain on assets held more than 5 years to remove taxation of the phantom gain from monetary inflation, to properly reflect the true constant dollar value of the gain.

Calculation of the adjustment would be simple, and require only a multiplication of the dollar gain using IRS supplied existing data on the cumulative inflation change from the year of purchase to the year of sale.

The current personal income tax code provides a lower tax rate for a "long-term capital gain" on an asset held for more than 365 days. This actually progressively penalizes longer-term investments that are held more than one year because of the failure to adjust for monetary inflation over the investment life. The investments that America needs to build a sustainable economy by starting or growing businesses, and building business infrastructure, are not 366-day investments. True long-term business investments may not provide a capital return for 10, 20, 30, or 40 years or longer. Even owners of relatively small businesses will generally be in the maximum rate bracket in the year they sell their business or business property resulting in taxation at the maximum rate. Most states also add an additional state tax of up to 10% on capital gains, based on the federal calculation.

The current law also provides the same tax treatment for individuals who invest in speculative secondary market investments such as traded stocks. <u>Except for new offerings, traded stock purchases provide no new economic investment or funding for business growth.</u> Ironically, secondary economic investments actually have a greater tax benefit because they can be easily sold after 1 year when the tax benefit is greatest. Where the asset is a business or investment property, this short tax incentive peak encourages the owners to focus on short-term "paper" profitability and the potential for resale, rather than long-term growth and sustainability. The 366-day incentive peak also encourages financial speculators to purchase and sell off asset rich businesses, rather than operating and growing them.

Almost all other value comparisons that extend over long periods such as economic statistics, government budgets, and other tax code provisions, are adjusted to remove the artificial effect of inflation. Although compensating for inflation distortion is part of the justification for having a lower tax rate on capital gains, this is a classic case where a "one size fits all" approach does not work. To illustrate the progressive disincentive for long-term investment under current law, the table below shows the real, post inflation, return and effective tax rate on a sample investment. It assumes a business was started, or an asset was purchased, for $1M in 1962 and held for periods of 2 to 50 years before being sold for $2M. The taxable gain in each case is $1M and the true constant dollar value of the gain from the year of investment was calculated using US Bureau of Labor Statistics CPI Inflation data. As the chart below shows, <u>the **effective tax rate on the real inflation adjusted gain grows significantly after 5 years,** particularly at a higher 28% tax rate.</u>

Holding Period.	Capital Gains tax paid at a 15% rate.	**Actual Real <u>Constant Dollar</u> value of the $1M gain.**	**<u>Effective</u> Tax Rate* on real gain** at a 15% rate.	Capital Gains Tax paid at a 28% rate.	**Actual Real <u>Constant Dollar</u> value of the $1M gain**.	**<u>Effective</u> Tax Rate* on real gain** at a 28% rate.
2 years	$150,000	$948,800	15.8%	$280,000	$948,000	29.5%
5 years	$150,000	$902,200	16.6%	$280,000	$902,200	31 %
10 years	$150,000	$782,800	19.2%	$280,000	$782,800	35.8%
20 years	$150,000	$610,050	24.6%	$280,000	$610,050	45.9%
30 years	$150,000	$419,900	35.7%	$280,000	$419,900	66.7%
40 years	$150,000	$181,900	82.5%	$280,000	$181,900	154 %
50 years	$150,000	$131,400	114.2%	$280,000	$131,400	213 %

***The effective tax rate is the current code tax amount on the paper gain, divided by the actual inflation adjusted value of the gain.**

The Federal taxes alone would actually exceed the total real economic gain after only about 35 years at a 28% tax rate. State Capital Gains Taxes, which are usually based on the federal calculation, can add up to 10% additional tax on the inflationary increase. Although an adjustment should be made on all assets held for more than 5 years, the scoring cost of initial correction legislation could be reduced by limiting the adjustment to business property or direct business investments where the taxpayer is an active owner. Potential revenue offsets for the inflation adjustment include increasing the "long-term" capital gains holding period to 2 or 3 years, or slightly increasing the capital gains tax rates.

4. Small Business "Pass Through" Entity Tax Reform Recommendations:

A. We support a more integrated tax code for all business income. As a first step, Congress should differentiate in the personal income tax code the net "pass-through income" from a business in which the taxpayer materially participates as "Small Business Operating Income" (SBOI). This would include non-salary income from sole proprietorships, partnerships, "S" corporations, farms, and other business income reported on a personal return.

Stimulating economic growth through the tax code is complicated by the fact that there are two business taxation systems. Most large businesses pay their taxes through the corporate tax system, which in 2010 collected about 10% of total federal tax revenues. Most smaller businesses are subchapter "S" corporations, partnerships, LLCs, Schedule "C" or Schedule "F" filers, and pay the taxes on their business operating income on their personal tax return along with their other personal income. The SBA estimates that over 90% of small businesses are pass-through entity taxpayers. As a result, the provisions and rates of the personal tax code can have an unintended negative impact on small business growth. When Congress considers economic stimulus measures or tax system reforms, it is important that both business tax systems be changed in unison. However, unless real pass-through business income can be identified and treated separately, any attempt to provide equitable treatment will result in significant revenue loss from non-business taxpayers.

In 2011, Congress raised effective tax rates on higher income individuals, many of whom are small business owners with the 3.8% Medicare surtax. Proposed reductions in the large corporation tax rate to 28% or less will potentially shift an even greater percentage of the tax burden onto small businesses and individuals. This will have a significant impact on small and midsize businesses that report their business operating income on the owner's personal return, in addition to the owner's other salary and investment earnings. This often results in the small business income being taxed at the highest individual tax rates. When compared to the low tax rates on dividends and capital gains of highly liquid "traded stocks", it is difficult for people to justify the higher risk, and lower after tax return, of most small business investments. Because of their more limited ability to borrow capital, small business operating income must often be reinvested in the business for survival and growth. This leaves little cash available to pay the taxes. It is estimated that two thirds of all small business employees' work for firms with 20 to 500 employees, and many of these firms are likely to be impacted by higher personal tax rates.

Income resulting from direct business investment and active operation of a business that employs people and sells a product or service has a much higher value to our overall economy than income resulting from passive speculative activity. By differentiating income from active businesses, Congress can provide targeted tax stimulus with less revenue loss, by not having to provide the same tax treatment on gains from passive investments such as traded stocks.

B. To provide an incentive for small business economic growth and job creation, Congress should set a lower maximum tax rate, comparable to proposed "C" corporation rates, on up to $500,000 of "Small Business Operating Income" reported on a schedule K1, C, or F, for a business in which the <u>taxpayer materially participates</u>. Matching AMT language must also be enacted to prevent the AMT from nullifying the effect of the provision.

This would allow a limited amount of small business income to be taxed at lower rates to encourage equity reinvestment to finance small business growth. Calculating the tax on this income separately from other personal wage and investment income will also prevent the taxpayer's other income from pushing the tax rate on the business income into the highest personal rate brackets.

The Personal Alternative Minimum Tax must also be adjusted for pass-through Small Business Operating Income because it is much different from the "C" corporation AMT, and significantly impacts tax liability on small business income. The combined reporting of both personal and business operating income on the owner's personal tax return often exceeds the relatively low personal AMT exemption level. This makes taxpayers calculate and pay additional Alternative Tax on their business income. This is compounded by the lack of deductibility under the AMT of state income taxes, which in some states can exceed 10%. As a result, many small businesses pay federal taxes on business "income" they never received, since it was paid in state income tax. In contrast, the Corporate AMT only applies if the 3-year average annual business income exceeds $7,500,000.

C. Provide better tax incentives to help small business startups survive and grow.

More than half of small businesses startups fail within the first few years, and tax policy can be a major factor in their ability to survive and grow. 1) The Congress should allow faster deduction of up to $250,000 of initial "startup expenses" that now must be taken over several years. 2) The current rate brackets for small C corporations are unrealistic and should be broadened and lowered to encourage business growth. The current rate for taxable income from $75K to $100K is 34%, from $100K to $335K is actually 39%, yet for major corporations over $19M the maximum rate is only 35% Some types of small businesses are required by law to be C corporations and almost all technology startups organize as standard corporations. These excessive rates on small corporations can be a major factor in business failures. 3. There is currently discussion in the Congress about removing the deductibility of business interest to encourage equity funding, but most business startups must borrow money to get started, and the inability to deduct interest would kill most startups. If changes are made to interest deductibility, they should at least allow interest on up to the first $1M of business borrowing.

D. P<u>ermanently</u> equalize the deductibility, up to a reasonable cost limit, of individual or group health insurance <u>at the entity level</u> for <u>all</u> forms of businesses and individuals by amending IRC section 162(l) (4).

For the year 2010 ONLY, the Small Business Jobs Act of 2010 finally allowed self-employed taxpayers, and partners, to deduct the cost of their health insurance, without paying payroll taxes on the insurance cost, as all corporations can. The equal and simple deductibility of group health insurance regardless of the legal form of business entity has been a key issue for small businesses for many years. Prior Congressional action partly corrected this problem for S Corporation stockholders, but 21 million self-employed individuals are still required to treat the expense as a <u>non</u>-business expense even if they provide identical coverage for their employees. This results in the taxpayer paying an additional 15.3% on the insurance expense. Because of their small group sizes, the self-employed already pay the highest relative insurance rates. This inability to deduct their own insurance has always been an emotional disincentive for small business owners to provide group health insurance for their other workers.

E. Provide equitable employee cafeteria benefit options for small business owners.

Small businesses compete for workers with large businesses and the public sector. Because of differing family situations, differences in benefit options available through other family members, or because of personal preferences, many employees often want different benefits than fellow workers.

The 2010 PPACA Health Care Bill included provisions for a simplified Cafeteria Plan. However, current restrictions make them unattractive for most small businesses, other than C corporations, because business owners cannot be part of the plan. Current law specifically prevents sole proprietors, partners, and sub chapter S corporation shareholders from participating in a cafeteria benefit plan. These limitations discourage small businesses from offering employees a very logical form of employment benefit and make small businesses less attractive for prospective employees.

F. Modernize and simplify the qualified home office deduction to allow de minimus personal use and the conduct of business with clients using electronic technology.

Currently, <u>home</u>-based businesses represent about 52% of all American firms and generate 10% of the country's total GDP, or economic revenue based on SBA research. In the future, that percentage is likely to grow as new technologies and the Internet make new business models possible and increase the ability of people to work remotely. Working from the home has become more attractive because of the increased costs of commuting, high commercial real estate rents, and parking costs. The government should also have an interest in promoting working at home as a way to reduce the need for new highway construction, conserve energy, and reduce "green-house gas" emissions from unnecessary commutes to a distant business office.

In 2012, the IRS provided a regulatory standard for a simplified home office calculation with a maximum deduction of $1500, but could not address some the basic statutory limitations of the existing code without Congressional action. Internal Revenue Code Section 280A(c) (1) defines the requirements that must be met to deduct home office expenses. It generally permits a deduction for a home office in a taxpayer's residence only if it is used "exclusively on a regular basis and meets one of two specific use requirements.

(1) The "principal place of business" requirement allows a deduction for a home office if it is "the principal place of business for any trade or business of the taxpayer", but the requirement is severely limited by regulations. Unfortunately, for many small businesses the inability "to conduct substantial administrative activities" at their regular place of business" is often the result of a lack of time, as much as a lack of space. Small business people can have a legitimate business need for a home office in which they can regularly work, even if it is not the "principal place" of business where they physically serve their customers.

(2) The "used by patients, clients, or customers" requirement has been interpreted by the IRS to require clients or customers to be physically present in the home office. IRS regulations state that conversations with taxpayers by telephone and electronic media do not constitute meeting with clients. The actual code only requires that it be "a place of business which is used by patients, clients, or customers in meeting or "dealing" with the taxpayer in the normal course of his trade or business." Today, many businesses "deal" with their customers without any physical presence. Major and minor business transactions are now fully completed, through websites, emails, faxes, video conferencing or just over the telephone. The old physical presence requirements are obsolete and block reasonable recovery of expenses for home-based businesses.

Even when a taxpayer meets one of the above use tests, the current Code also requires any home office space to be used "exclusively" as a place for business. This is a much higher standard than is applied to regular, fully deductible business office locations. It is a reality of today's business world, where employees carry cell phones and work on computers connected to the internet, that most workers conduct some personal business and receive some personal calls or emails at their place of business, even in government offices. It is both unrealistic and unreasonable not to also allow some de minimus personal activity in an otherwise qualified home office area. The current regulations and case law do not provide sufficiently clear and equitable standards for deductibility. Many at-home workers are afraid to deduct the use of a home office for fear of audits, the extra record keeping, and the required calculations.

G. Modernize the unrealistic "Luxury" automobile depreciation limitations for business use. Depreciation and expensing limits for vehicles should be adjusted to allow a person who needs to use an automobile for business to fully recover the cost of a $25,000 vehicle, with 100% business use, during the standard 6-year recovery period. That amount should be periodically adjusted for average vehicle costs.

The tax code defines passenger automobiles as 5-year property under ADS standards for cost recovery. However, in 1984 Congress limited the ability to expense or depreciate what they thought were "luxury" automobiles used for business by enacting Section 280F(a)(1). These limits have only increased by about 25% since 1987 because of a restrictive calculation formula based on the characteristics of a typical 1984 car, even with general inflation of over 90% in that time. That means that during the "normal" 6-year recovery period, a business could actually only fully recover the cost of a $16,935 vehicle. Because of the deduction limits, it would take 11 years to recover the cost of a $25,000 car. With average use of only 15,000 miles a year, a car used 100% for business would have 165,000 miles at the end of that 11-year period. To consider any automobile costing over $17,000 to be a “luxury car” is simply unrealistic. The only vehicles that still sell below this depreciation limitation are small compact cars. The depreciation limitations also cause businesses to keep older, more polluting, and less fuel-efficient vehicles in use. The current minimum weight standards that provide exemption from the deduction limitation have also caused people to buy larger, less fuel-efficient vehicles than they actually need.

H. Increase the deductibility of business meals for small businesses up to 75%.
The 1995 White House Conference on Small Business identified the importance of the business meal deduction to the success of small business. They often do not have appropriate space at their business to meet and work with important clients, referral sources or suppliers. Large businesses often have meeting and conference rooms at their facility that are tax deductible. Small businesses, particularly home based businesses, may have only their kitchen table. They often have to use restaurants as an opportunity to prospect for business and to complete transactions with clients. Existing code provisions limit excessive meal or entertainment expenditures.

I. Simplify the matching of third party payment reporting on Form 1099 K by correcting the code to require NET income reporting.
Congress made a technical error in the legislation requiring third party payment processors to report annual proceeds as an enforcement provision “pay-for” in the PPACA health care reform package. The current legislation requires credit card companies, finance companies, and other payment processors to report GROSS sales processed to the IRS. Instead, the legislation should have required reporting of NET revenue actually received by the business. This net amount is after return credits, processing discounts of 2% to 5%, and other charges, and is the information they provide to every business monthly. It is the actual income for the business. Purchasers, paying with debit cards, can further confuse the reporting, because they also often have the option to get “cash back” in addition to the sale transaction. This may be reported in the business’s gross transactions, but is not income in any form.

The IRS has tried to work around this flaw in the legislation by building average estimates of what percentage of net income might result from gross transactions, but many businesses are not “average”, and it is resulting in too many “false positive” examinations. This is particularly true of online businesses where all of their sales are by bankcards and the difference between gross and net proceeds can be much greater.

J. Return the contribution due date for IRA investments to the extended return due date.
Prior to the Tax Reform Act of 1986, standard IRA contributions, like all other retirement plan contributions, were permitted up to the earlier of the extended due date of the return, or when the return was filed. Their due date is now April 15, with no extensions. This causes a burden on taxpayers who have to make IRA contributions at the same time that both prior year final tax payments and their current year first quarter estimated tax payment are due. This often results in taxpayers, particularly small businesses, sacrificing their own IRA contribution to meet other expenses.

Because the income limitations on converting standard IRA accounts to Roth IRA accounts have been removed, Congress should also remove the income limits on direct contributions to Roth accounts. This would eliminate the need for a two-step process of contributing to a regular account and then having to convert it to a Roth account.

5. International Corporate Tax Policy Recommendations:

Congress should change the taxation of multi-national and foreign businesses to better equalize the tax burden with domestic businesses and prevent tax avoidance through profit shifting to lower tax countries and corporate inversions. It should also remove the ability of businesses to defer taxation of foreign profits, currently estimated at $2.4T, until repatriated because of the provision's negative impact on US reinvestment.

A. If Congress decides to retain an income based corporate tax similar to the current code, it should tax the profit of US Corporations from all their controlled foreign business subsidiaries and other investments on a "world-wide" basis as current income, with out deferral, in the year in which it is earned, and then allocated on the basis of the percentage of final sales by country. Existing un-repatriated foreign profits should be fully taxed over a 10 year period because reduced repatriation rates would provide no new domestic economic incentive. If necessary to facilitate reasonable accounting and tax reporting cycles, some foreign business income could be allowed to be reported in the following tax year. Non-income based foreign taxes should also continue to be deductible. The reported income should be based on generally accepted international accounting standards, and be adjusted for any special economic incentives provided by foreign governments.

B. For longer-term consistency with other international taxing systems, Congress should thoroughly evaluate moving toward a revenue neutral value added tax as a creditable minimum tax on business transaction income that apportions tax collection based on where increases in product "value" occur. Because of transition impacts, any consumption based VAT tax rate should be phased in over a ten-year period. If an invoice based VAT is adopted, businesses should also be given at least a two year implementation period. A WTO compliant VAT is the best way to achieve border adjustability to provide better tax equitability on US exports and foreign imports. Taxing the value added by a business in each country also better reflects the business size and its impact on Federal and local government services. Any arbitrary "border tax" or tariff which does not meet WTO equitability requirements should be avoided because of long-term negative economic impacts on US trade.

The tax code taxes the income from offshore investments of US individuals on the same basis as if the income was received domestically, less the credit for the foreign income taxes paid. The code also taxes domestic businesses with subsidiaries on the basis of their combined income and assets. The same standard should apply to foreign earnings of US corporations. The current tax system does not tax earnings of foreign subsidiaries as US income until they are transferred back to the parent corporation. This allows multinational corporations, particularly those with high intellectual property values, to use inter-division accounting manipulations to transfer taxable profits to divisions in lower tax countries where the earnings can multiply. This not only reduces

US tax income, but also creates a tax incentive barrier to recognizing and re-investing those earnings in the US for domestic business growth. When intellectual property is developed with US Research and Development tax credits and protected and given value by the US Patent system, the profits from that research should be taxable in the US.

Allocating taxation of profits based on the location of sales or other factors has long been used to allocate profits of national businesses between the states. Currently 21 states use a single sales factor for allocating taxable profit and 17 states use a double weight sales or other factors allocation formula. It is also a logical way, with careful limitations and interaction with other countries, to allocate taxable profits internationally. Taxing on the basis of national sales would remove the incentive for profit shifting by multi-nationals. It would also discourage the game of countries bidding down their tax rates to attract tax shifting and allow them to increase revenue for their countries.

There is also a need to improve corporate transparency. The US tax system is based on all taxpayers paying their fair share of taxes. To improve compliance Congress passed the Foreign Account Tax Compliance Act (FATCO) requiring the reporting of foreign investments of US citizens. While this has been successful in helping to identify foreign accounts and get US taxpayers to pay taxes on that income, the same does not hold true for holders of US accounts.

Many corporations, especially those incorporated in states, like Delaware and Nevada, are not required to reveal the beneficial owners of the entity or the corporate bank accounts. It is easier to set up one of these corporations than to obtain a library card. As the 2016 "Panama Papers" disclosures revealed, shell corporations are widely used to avoid taxes, launder money, and even finance terrorism. This hurts all legitimate businesses and reduces the revenue that governments need to fund public services.

Congress should pass legislation to require the disclosure of beneficial owners of all US corporate entities and bank accounts, with reasonable safeguards to prevent misuse of the information and identity theft.

This Policy Paper was prepared for the National Small Business Network by:

Eric Blackledge and Thala Taperman Rolnick, CPA

National Small Business Network 4286 45th Street South St Petersburg, FL 33711
Phone 541-829-0033 Fax 541-752-9631 Email Tax@NationalSmallBusiness.net
Related research and information is available on our website at www.NationalSmallBusiness.net