National Small Business Network

Business Tax Reform for Economic Growth

NSBN Policy Recommendations for the 114th Congress

February 2015

These 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. They focus primarily on business tax reform issues, particularly for small businesses, because of their greater importance in promoting economic growth, and because both the Administration and Congress have suggested them as a starting point for any reform.

Basic Tax System Principles for Economic Growth:

- **Simplify and coordinate our overly complex tax code to improve voluntary compliance, provide equitable treatment for all taxpayers, and reduce both taxpayer and IRS administrative expense.**

- **Make sure business tax reform provides incentives for the growth of small businesses, who provide half of all jobs, as well as for large corporations.**

- **Encourage long-term direct business investment by taxing only real economic income, not the effect of monetary inflation by adjusting all tax code provisions to reduce inflation distortions.**

- **Encourage domestic investment and job creation to the greatest extent possible within the limits of international agreements.**

- **Assure that any tax reform provides adequate overall revenue to gradually reduce our national debt and restore long-term fiscal stability**. Unfortunately, the "bottom line" is that tax reform needs to be at least revenue neutral, and will need to be somewhat revenue positive overall to reduce our debt and unfunded future obligations. Although limited deficit spending can stimulate the economy, most economists agree that continuing deficits and our current $18 Trillion national debt reduce economic growth, are a very real threat to the future stability of our economy. Please see our related recommendations on budgeting and Fiscal Reforms for Sustainable Government on our website at www.NationalSmallBusiness.net

Background:

Taxes are not the cause of our current economic and under employment problems. 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 at a time of record corporation earnings, corporation income tax revenues have fallen from 5.0% of gross domestic product in 1952 to only about 1.6% today. Some of this reduction results from smaller corporations converting to subchapter S corporations whose income is reported as personal income tax. Some of it also appears to result from larger corporations avoiding taxes by shifting taxable income to foreign countries with lower tax rates.

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. 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. But as the last 10 years have proven, lower tax rates did not promote sustainable domestic economic growth.

Issue Index:

1. Tax Expenditure and Special Tax Rate Recommendations

Review all tax expenditure provisions and special tax rate incentives for their true value as an economic, employment, social, or environmental incentive. All tax expenditures and special tax rate provisions without fixed expirations should be re-evaluated at least every 10 years for possible modification or progressive elimination. Pass multi-year targeted tax incentives such as business deductions, credits, and accelerated write-offs that are proven to effectively support direct domestic business investment and employment. To obtain the best economic return from tax expenditures, pass them well in advance, and do not waste resources on retroactive incentives.

Tax reform discussion in the 113th Congress ended unsatisfactorily with only a last minute 1 year extension of basic business and investment incentives, most of which have already expired. 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 also 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 policy impact 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.

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 an adequate decision making data matrix 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. The report should include at a minimum -

- A summary of the tax expenditure or rate preference, and original reason for it.
- The tax revenue cost over 10 and 20 year periods.
- An estimate of who is actually benefited by the provision, by number and type of taxpayers and by income level; or type of business and total employment and the national economic importance of the provision.
- An evaluation of the total secondary economic benefits and the potential economic multiplier for the expenditure.
- The effectiveness of the tax expenditure in actually causing the desired activity and the potential negative effects of elimination.
- An evaluation of whether there is still a current need for the tax expenditure.

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.

A. Increase the role of the Joint Committee on Taxation and Treasury-IRS in assisting Members of Congress in the ongoing development of a simpler and better coordinated federal tax code. The complexity of the tax code is the result of many decades of changes and additions by individual Members of Congress layered on top of prior legislation without overall coordination. Many of these provisions conflict with similar or even contrary provisions in existing code. Other provisions have become outdated by changes in technology or business practices. This complexity makes it difficult for taxpayers, and even professional tax preparers, to understand and comply with the code. The complexity also increases the administrative burden on the IRS and makes it difficult for them to provide good taxpayer assistance and assure 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. JCT and the IRS should 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 education and assistance, and inadequate IRS budgets will eventually threaten accurate and equitable enforcement of the law. If this happens, it will also reduce collection of the revenue needed for all other Federal programs and services.

The Congress and Administration need to recommit to the goals of the 1998 IRS Reform and Reorganization effort by providing better support for improvements to technology systems and stronger management emphasis on business process re-engineering and 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. But, the IRS needs increased Congressional budget support and better proactive communication on agency issues. The Administration also needs to complete 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 or 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 dollar limitations which should have periodic adjustment. The

provisions should require a reasonable minimum inflation change before a periodic adjustment is made.

D. 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 $500, which makes the listed property requirements even more illogical.

E. Simplify state income tax nexus issues for out-of-state businesses by adopting a modernized federal prohibition on state income and business activity taxation, of both services and products, including digital products, delivered from outside a state via public carriers or 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 and often have filing minimums which 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 some service businesses, it is difficult to determine which states have a valid tax nexus. With the growth of "cloud computing" and web-based applications, a person working on a computer in Arizona, using data on a server in New York, for a business website that is used world-wide, could be viewed as having nexus almost anywhere. Some States are now trying to use national internet search engine advertising contracts, which are often used by small business to offset some of their website expenses, as a basis for claiming tax nexus. These new "Amazon Laws" have already been adopted in 24 states, and will spread rapidly, if not controlled by federal legislation. Other states, such as California are trying to extend nexus just because of contracted relationships or corporate affiliations with suppliers within the state.

The "Commerce Clause" of the Constitution makes the Congress responsible for preventing the states from enacting barriers to interstate commerce. In 1986, the Congress passed Public Law 86-272 to remove multi-state tax nexus barriers for mail order marketing of goods. That law prohibits states from imposing a "net income tax" on businesses if the contact with a state is "limited to the solicitation of orders through catalogs, flyers, and advertisements in national periodicals, for sales of tangible personal property which are approved outside the state and are filled from a stock of goods located outside the state and delivered via common carrier or the U S Postal Service." This law, unfortunately, did not envision the ability of business to deliver services, as well as products, via the internet and other electronic technologies.

Many businesses also conduct limited amounts of business in other states at conferences, trade shows, and national product market centers which may create nexus under some state's laws. Limited business activity of this nature should also be protected from multi-state income taxation. Quick Congressional action can prevent this problem from growing, and reduce a major non-value-added cost on small businesses without any Federal cost.

F. Protect each state's right to use sales, transaction, or consumption taxes, and simplify retailer remittance of interstate consumption taxes, by passing marketplace equitability legislation.

Congress should support effective and efficient interstate collection of state sales and use taxes, and provide an equitable business environment for those businesses that properly collect state sales taxes, by passing marketplace fairness legislation, along with a long-term renewal of the Internet Tax Freedom Act. A federal sales tax administration law would not create any new taxes, but 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 reflect the true constant dollar value of the gain. Calculation of the adjustment should 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 366 days. This actually progressively penalizes investments held more than one year because of its failure to adjust for monetary inflation over the investment life. The President's 2015 budget proposal to increase the capital gains tax rate for top bracket earners to 24.2% or 28% total , including the 3.8% ACA surtax, would make the inflationary distortion even greater. And, even owners of relatively small businesses would generally be in the maximum rate bracket in the year they sell their business or business property. And most states also add an additional state tax of up to 10% on capital gains The investments that America needs to build a

sustainable economy by starting or growing businesses, or 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.

The current law also provides the same tax treatment for individuals to invest in speculative secondary market investments such as traded stocks which, except for new offerings, provide no new economic investment or funding for business growth. Ironically, secondary economic investments actually can 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. This 366 day peak incentive 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 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, after 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, the **effective tax rate** on the real inflation adjusted gain grows significantly after 5 years, particularly at a higher tax rate

Holding Period.	Capital Gains tax paid at a 15% rate.	**Actual Real Constant Dollar value of the $1M gain.**	**Effective Tax Rate* on real gain** at a 15% rate.	Capital Gains Tax paid at a 28% rate.	**Actual Real Constant Dollar value of the $1M gain**.	**Effective 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.

At a 28% tax rate, the federal ~~tax would actually exceed the total real economic gain~~ after only about 35 years Although an adjustment should really 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 and active owner.

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

A. To provide targeted small business growth incentives, with the lowest revenue cost, Congress should differentiate in the personal income tax code all 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 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 9% of total federal tax revenues. Most smaller business 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. But, 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. 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, on top of their 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 on 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, leaving 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 the higher personal tax rates.

Income resulting from direct business investment and active operation of a business which employs workers 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. Congress should enact 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 taxpayer materially participates. 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 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 than 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 the 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.

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."

Ideally, Congress should eliminate the burden of AMT calculation for most taxpayers, although the cost would be high. The tax code should at least provide better equality in the AMT treatment of "Small Business Operating Income" reported on a personal Form 1040 return, with the far higher "C" corporation AMT exemption.

C. Congress should permanently equalize the deductibility, up to a reasonable cost limit, of individual or group health insurance at the entity level for all forms of businesses and individuals by amending IRC section 162(l) (4). The deductible limit should be adjusted for average health insurance cost inflation.

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 corporation 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 non 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.

As more states and the Federal government mandate universal health insurance coverage for all individuals, the impact of this inequity for the self-employed will continued to grow unless corrected. The National Taxpayer Advocate has recommended correction of this inequity in her Reports to Congress. Without Congressional action to re-instate equal exclusion of health insurance from payroll taxes, the 21 million self-employed again face this health care penalty for 2015, along with other health insurance cost increases.

D. Congress should permanently enact an exclusion on at least 75% of the gain on Section 1202 qualified small business stock and remove the add-back in the AMT calculation. This could revitalize an important tool for small business financing, particularly if capital gains rates increase in the future. As an alternative, Congress might provide an alternative 20% tax credit for investment in Qualified Small Business Stock held for 5 years or longer.

Congress passed Section 1202 of the tax code to encourage direct investment in small business startups. Most business startups are under-capitalized and are financed largely with expensive short-term borrowing. This is a major reason for their high failure rate. These provisions were adopted to provide new businesses with a stable base of equity capital to survive and grow. It is very difficult for new businesses to obtain equity capital because of the far higher risk and lack of market liquidity of small business stock compared to other investments.

Section 1202 provided an incentive of a 50% exclusion on the capital gain from a sale of Qualified Small Business Stock held for more than 5 years. The exclusion was raised to 75% in 2009-10, and even to 100% through 2014. However, the taxable portion was subject to a 28% tax rate, rather than the 0% or 20% rates that applied to the gain on traded stock sales. The low capital gains tax rates on safer and more liquid investments combined with the requirement to add back 7% of the excluded gain in calculating alternative minimum taxable income effectively eliminated much of the value of this incentive. The Administration's 2012 Green Book recommended making the 100% exclusion permanent to "…encourage and reward new investment in qualified small business stock."

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 that may be available through other family members or because of different personal preferences, many employees often want different benefits than other 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 illogical limitations discourage small businesses from offering employees a very logical form of employment benefit and makes small businesses less attractive for prospective employees.

F. Congress should make permanent the $500,000 expensing limitation for Section 179 property, so businesses can plan for future new equipment investments when they are

needed under consistent rules. Congress should also make permanent, the ability to revoke Section 179 expensing on amended returns, and to expense "off the shelf" computer software.

The Section 179 small business expensing provisions are a key factor in helping small businesses, particularly new start-ups, survive and grow by improving their ability to quickly recover the costs of investments in new equipment. This provides a major stimulus to the general economy from increased purchasing capability, particularly with the limited credit available to small and new businesses. The expensing limit was increased to $500,000 by the Taxpayer Relief Act of 2012 for 2013, and extended for 2014, but reverts back to $25,000 for 2015 and future years.

The Act also extended through 2014, only, the expiration date of IRC 179(c) (2). This provision allows taxpayers to revoke a Section 179 election on an amended return. This option is important for owners of "pass through" entity businesses, particularly those who own interests in multiple businesses. This is because the maximum Sec. 179 expensing limits are applied at both at the individual business level and at the final taxpayer level. A change in election is often needed when the owner taxpayer receives too much pass-through expensing from multiple businesses. This often happens when assets or income were accidently excluded from the original return, or the IRS re-classifies an expensed item as a capital asset. Unless the originating business has the option to change the Section 179 expensed amount on an amended return, a recipient taxpayer could be allocated a deduction greater than they are allowed to use. Any excess allocation would reduce the taxpayer's basis in the business without providing any offsetting deduction, resulting in a permanent tax benefit loss. It is important that IRC 179(c) (2) be made permanent regardless of the level of expensing limit.

G. Make permanent the inclusion of limited non-structural real property improvements under Section 179 expensing.

In 1958, when Section 179 was first approved, the US economy was strongly manufacturing oriented and most small businesses needed to purchase production equipment. Over the last 50 years, the US economy has become more service and innovation oriented and the capital expenditure needs of small businesses have changed.

Today, to compete for customers and clients, businesses need functional and attractive facilities in which to conduct business. Better facilities also help businesses attract and retain more highly skilled employees. New businesses often face significant remodeling costs to prepare a business property for their use, and older businesses need to regularly update their facilities. These improvements must then be recovered over a long period of time. Currently most real property improvements have to be depreciated over 39 years. This may be appropriate for new construction, but is far too long for most commercial remodeling cycles. This can consume a large amount of a business' initial capital, and make it difficult for the business to survive and grow. Congress has previously recognized the changing capital investment needs of businesses by reducing the depreciable life of qualified leasehold improvements, qualified restaurant improvements, and qualified retail improvements to 15 years in recent short-term stimulus measures. These provisions should be re-enacted and made permanent.

The Taxpayer Relief Act of 2012 included the inclusion of up to $250,000 in certain real property improvements to qualified leasehold, restaurant, and retail facilities under Sec. 179, but this was

extended only through 2014 and needs to be re-enacted. The language of the legislation also prevented business taxpayers who also own the property, either directly or indirectly, from taking equal expensing treatment. This inequity should be addressed in future legislation.

Congress should make permanent the provisions to allow expensing building improvements under Section 179 up to $250,000 or the maximum Section 179 limitation. This limited expensing should also be allowed for all types of businesses including businesses owned by the property owner. For more expensive improvements which must be depreciated, Congress should permanently shorten the standard depreciation period for nonstructural leasehold, restaurant, retail and professional real property improvements to 15 years. These changes would have significant short-term and long-term economic stimulus effect.

H. Modernize and simplify the qualified home office deduction.

Currently, home-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 deduction with a maximum of $1500, but failed to address some basic statutory limitations of the existing code. 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 during the day 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. .

I. Modernize the unrealistic "Luxury" automobile depreciation limitations. 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. Many business users easily exceed that annual mileage. To consider an automobile costing less than $17,000 a "luxury car" is simply unrealistic. The only vehicles that still sell below this depreciation limitation are small compact cars. None of these vehicles are designed to transport five adults, nor are suitable for many valid business uses such as transporting samples. Many of these cheaper cars are also imported, which has helped contribute to the decline of American auto manufacturers. The depreciation limitations also cause businesses to keep older, more polluting, and less fuel-efficient vehicles in use. The tax code should encourage business owners to regularly replace business vehicles, not unreasonably discourage it. Removing this antiquated provision will stimulate business purchases of new vehicles, and help rebuild the American auto industry.

J. 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 which are tax deductible. Small businesses, particularly home based businesses, may have only their dining room table.

They often have to use restaurant meals as an opportunity to prospect for business and to complete transactions with clients. Research has indicated that increasing the deductibility of business meals to 80% would increase restaurant sales by $12 Billion and create an overall economic impact of $24 Billion. Existing code provisions limit excessive meal or entertainment expenditures.

K. 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 15th, 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.

Congress should return the due date for IRA contributions to the due date of the return, including all permitted extensions, as allowed for other retirement plans. 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:

Tax the income of US Corporations from controlled foreign business subsidiaries or other investments as current income in the year in which it is earned, on the same basis as income from a US division or investment, less a credit for the foreign income taxes paid. 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 incentives provided by foreign governments.

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.

6. National Infrastructure Repair and Improvement Recommendations.

Good infrastructure is vital to continued economic growth. Congress should, as a beginning step repair our deteriorating transportation systems, by rebuilding the depleted Highway Trust Fund. Increase the current Highway fuel tax rates, last set in 1993, from 18.4 cents per gallon for Gasoline to at least 30 cents per gallon, with comparable increases for diesel fuel and further increases in later years. This should have been done years ago and gradually phased in, but the current decline in oil prices provides any opportunity for an increase now without significant economic hardship. Reducing our consumption of greenhouse gas producing carbon fuel, and our strategic dependence on foreign oil, are important national objectives. Let the market based incentive of higher fossil fuel costs reduce unnecessary consumption and emissions. The added revenue can be used to help build a modern transportation infrastructure, including good public transit, rather than continuing to send our dollars to foreign oil supplying countries.

Good transportation infrastructure is vital to the US economy, but much of our current system is deteriorating and is inadequate for future needs. The federal transportation program, funded by the federal fuels tax, has been the primary source of system improvement funding, along with state and local funds. After years of watching the program go broke from under funding, Congress rushed through a stop gap measure, P.L. 113-159, in August of 2014 that is neither a logical, nor adequate, solution. It reauthorized funding just until May 31 2015, and provided no sustainable funding base to rebuild the program. It was "funded" with an increased general fund deficit, and short term revenue scoring from requiring businesses to reduce pension plan funding for workers. This was short sighted, and a better solution needs to be developed.

Transportation projects often take 5 to 30 years from planning to completion and require reliable long term funding sources to be done efficiently. Funding for transportation improvements should also come from those who use and benefit from the system. Because of the progressing changes in modes of transportation and the development of alternative fuel vehicles transportation system funding will probably need to move beyond a simple fuel tax at some point. But, development of new complex funding approaches will probably take years and require major interaction with all the states.

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