

National Small Business Network

Tax Reform for Sustainable Economic Growth

Policy Recommendations for the 115th Congress

September 2017

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 by increasing our national debt to provide a short-term stimulus. The following tax reform recommendations are suggested 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.

To support sustainable economic growth through tax reform, Congress and the Administration should:

- **Carefully evaluate all major tax change proposals before enactment to fully understand and prevent negative secondary economic consequences.**
- **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, rather than profits from speculative transactions.**
- **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 competitiveness, and reduce the ability of multi-national corporations to avoid taxes by shifting profits to lower tax rate countries by taxing all multi-national corporations on the basis of their US sales and impacts.**

- **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 at least revenue neutral and provides adequate overall revenue to gradually reduce our national debt and restore long-term fiscal stability. Avoid “scoring games” which trade short-term stimulus for long-term revenue loss and increased deficits.**

Unfortunately, even with short term economic stimulus effects, tax reform will need to be revenue positive overall to reduce the national debt and unfunded future obligations that were authorized, by prior Congresses. This year’s GAO Report to Congress on the Nation’s Fiscal Health (GAO 17-237SP) concludes “The federal government is on an unsustainable fiscal path” with spending exceeding revenue by \$587 billion in 2016, and the projected debt growing to 100% of total GDP in 15 years. 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. We support the GAO recommendations, and those of other study groups, for re-establishing fiscal sustainability.

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 fourth 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.

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.

Key Issue Areas:

1. Avoid Tax Changes with Negative Secondary Economic Consequences	Page
2	
2. Tax Expenditure Long Term Policy Recommendations	
Page 4	
3. Tax Simplicity, Equitability and Administration Recommendations	
Page 5	
4. Capital Gains Reform Recommendations	
Page 6	
5. Small Business “Pass Through” Entity Tax Reform Recommendations	
Page 8	
6. International Corporate Tax Reform Recommendations	
Page 10	

1. Avoid Tax Changes with Negative Secondary Economic Consequences. When looking for ways to raise tax revenue, it is easy to jump at ideas that may appear to generate scoring revenue, without understanding the negative secondary impacts the change may have on the economy and employment. Several provisions of the original House “Blueprint” tax reform proposal could have had negative long-term consequences for the economy.

The now abandoned Border Adjustment “Tax” proposal, which would have prevented US resellers from deducting their cost-of-goods-sold on foreign products or components they import, was unworkable and could have devastated the US consumption based economy. It would have created a permanent 25% to 45% competitive cost disadvantage for US businesses compared to foreign business selling directly to US consumers from Canada, Mexico and other countries. We strongly support the decision to remove this dangerous proposal. Formulary Allocation (FA) of multinational business profits, as detailed in Section 6 on International Taxation, is a much simpler and less economically disruptive solution to stimulate US exports and solve the problem of corporate tax avoidance caused by profit shifting, inversions, and tax deferral.

Immediate expensing of capital investments, including even real property development, also sounds tempting for short term economic stimulation, but should be rejected. It probably would cause some short-term economic activity, but businesses only benefit in the long-term from careful investment in assets they truly need, even if the purchase provides a tempting reduction in current year taxes. In future years there would be no depreciation expense to reduce taxable income, so businesses may face significantly higher taxes, which they may not have adequate cash reserves to pay. This violates good accounting principles and could result in business declines or failures.

By allowing immediate expensing, the Congress would also remove their ability to provide extra economic stimulus during the next recession, with potentially disastrous consequences for economic recovery. It would also result in a significant reduction in short-term business tax revenue since these businesses would essentially be borrowing part of the cost of the investment from the Federal government. This would further add to the already rapidly growing and unsustainably high Federal deficit.

The elimination of the deductibility of interest on business borrowing, as a revenue raiser, could also have negative economic impacts. Deductibility of borrowing costs is particularly important for the development and growth of small businesses who can't generally issue stock to get needed capital, and also generally pay the highest interest rates. If deductibility of interest is limited for large corporations, interest deductibility should at least still be allowed for small businesses with net sales under \$10M, who depend on borrowing for growth.

2. Tax Expenditure Recommendations

Tax deductions and special tax rates for different types of income are government expenditures, just like direct budget appropriations. All tax expenditures and special tax rate provisions should be evaluated for their true effectiveness at least every 10 years. 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 so they actually effect decisions, 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, or emergency stimulus during recessions. 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" 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. 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

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 actual economic benefits of all tax expenditures.

3. 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. Continue to revitalize the management and business systems 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 most 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 lap-top computers and tablets.

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 income often subjects small businesses to significantly higher accounting and tax preparation expenses, and a higher total tax liability

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, and international, collection of state sales and use taxes. Market Place Fairness legislation would provide an equitable business environment for those businesses that properly collect state sales taxes. A federal interstate sales tax administration legislation 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. Because an increasing volume of internet consumer sales are originating from outside the US, the Congress should also consider international agreements and other actions that can help states collect use taxes on foreign direct sales.

4. 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. Except for new offerings, traded stock purchases create no new economic investment or funding for business growth. 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 some 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, the **effective tax rate on the real inflation adjusted gain grows significantly after 5 years**, particularly at a higher 28% 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.**

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 participant. Potential revenue offsets for an inflation adjustment include increasing the “long-term” capital gains holding period to 2 or 3 years, or slightly increasing the capital gains tax rates.

5. 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 must differentiate in the personal income tax code the net “pass-through business income” from a non-passive business in which the taxpayer materially participates, as “Small Business Operating Income” (SBOI). This would include income from sole proprietorships, partnerships, farms, non-salary income from “S” corporations, 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. 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 a 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.

Proposed reductions in the large corporation tax rate to 28% or less could 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 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 annually for the business to survive and grow. 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 owners are 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. Provide an equitable incentive for small business economic growth and job creation, by setting 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 small business growth. Calculating the tax on this income separately from other personal wage and investment income may also prevent the taxpayer's other income from pushing the tax rate on the business income into the highest personal rate brackets. Although the IRS currently has "reasonable compensation" rules to prevent shifting of personal service or salary income into pass-through entity income further regulatory clarification may be needed to prevent abuse and provide clear guidance for businesses.

The Personal Alternative Minimum Tax must also be adjusted for pass-through Small Business Operating Income because it is much lower 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 very low personal AMT exemption level of \$54,300, or \$84,500 for joint filers. This makes taxpayers calculate and pay additional Alternative Tax on their business income. In contrast, the Corporate AMT only applies if the 3-year average annual business income exceeds \$7,500,000. 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.

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 \$25,000 of initial organization and startup expenses that now must be amortized over 15 years. Some types of small businesses are required by law to be C corporations and almost all technology startups organize as standard corporations. The current rate brackets for small C corporations are unrealistic and should be broadened and lowered in rate to encourage business growth. The marginal tax rates step up quickly from 15% to 34% at only \$75,000. Over \$10M income is taxed at a 35% flat rate. These excessive rates on small corporations can be a major factor in early business failures.

D. 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.

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 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.

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, 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.

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. This is a much higher standard than required of regular business or governmental offices. The code also requires the office to be "used by patients, clients, or customers". This language in the code has been interpreted by the IRS to require clients or customers to be physically present in the home office. Today, many businesses do business with their customers without any physical presence. It is both unrealistic and unreasonable not to also allow some de minimus personal activity in an otherwise qualified home office area and to allow the use of digital business practices. Congress should make these changes by statute.

G. Modernize the unrealistic "Luxury" automobile depreciation limitation 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, without bonus depreciation, during the standard 6-year recovery period with 100% business use. That amount should be periodically adjusted for average vehicle costs.

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 can only recover the cost of a \$16,935 vehicle, which may be inappropriate for many business uses.

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. Other existing code provisions can properly limit excessive meal or entertainment expenditures.

I. Simplify the matching of third party payment reporting on Form 1099 K by correcting the law 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 on a gross basis. 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.

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.

K. Increase the Federal Estate Tax exemption amount to \$10 Million per person with, other current provisions to protect mid-size family businesses and farms, but do NOT repeal the Estate Tax.

The current estate tax exemption of about \$5.5 Million per person, or \$11 Million per couple is adequate to protect 97% of small family businesses and farms from a federal estate tax impact. However, the estate tax is still an important business continuity issue for faster growing mid-size businesses and larger farms because of rising land values. The Estate tax should not be repealed though, because far more small businesses and farms would be hurt by high capital gains taxes when they are sold to children or others, without the step-up in basis as part of the current Estate Tax A

5. International Corporate Tax Policy Recommendations:

Congress should change the taxation of domestic multi-national businesses (MNB) to a formulary allocation system based on their percentage of sales in the US, to remove the incentive for profit shifting to lower tax countries and for corporate inversions. This would put them on the same tax allocation basis as foreign owned multinational businesses with US taxable income and remove some or all of the US income tax cost burden on exported goods. As part of the change Congress should remove the Section 199 “manufacturing” subsidy, the credit for foreign income taxes paid, and the provision to defer taxation of foreign profits until repatriated, which are currently estimated to total \$2.4 Trillion.

The current corporate income tax system provides US tax credits for foreign taxes paid by subsidiaries, but does not actually tax earnings of foreign corporate subsidiaries as US income until they are transferred back to the parent corporation. It also allows multinational corporations, particularly those with high intellectual property values, to use inter-division accounting manipulations to shift 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.

The US should continue to tax the profit of US Corporations from all their controlled foreign business subsidiaries and other investments on the world-wide” basis. The worldwide taxable profit, and any tax credits, should then be apportioned on the basis of the percentage of final sales, or a combination of sales, assets, and employment in the US. There should be no reduced tax rate on repatriated profits because a lower rate would provide no new economic incentives, since the profits are from prior year’s sales. Repatriation will probably also not result in any major US economic benefit from new domestic corporate investment based on economist analysis. Analysis of the last voluntary repatriation incentive found the funds were primarily used for increased dividends and stock buy-backs. The tax rate on repatriated profits does not affect current business competitiveness and businesses have already applied the credits for foreign taxes paid against other income. This deferred tax is owed, and forced recognition and taxation of the \$2 Trillion + in deferred off-shore profits would add significant tax revenue to reduce the deficit, or provide alternate tax relief.

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.

Formulary Allocation (FA) would be the simplest of "border adjustable" options, with few transition or regulation issues, and no negative impacts on domestic businesses. It would utilize the existing US corporate tax code and international accounting standards, up to the final step of per country allocation. MNBs, with US tax nexus would calculate taxable income on a worldwide basis, but only pay US income tax based on their percentage of sales, or other economic impact factors, in the US. FA meets the stated bi-partisan Congressional objectives for international tax reform, including removal of US income tax cost on American exports.

FA would make it easier for corporations to correctly calculate their US taxes, and for the IRS to accurately audit them since it would more closely match the unified reports MNBs produce for financial reporting purposes. The US states, and political subdivisions in some other countries, have used a sales factor, or multi factor allocation system including sales, employment, and assets, for many years. Most multi-national corporations with US state nexus already report their state income tax liability on that basis now. The US already taxes multinationals on a worldwide basis, except for foreign headquartered corporations, who are treated on an activity nexus basis very similar to the way they would be treated under a formulary allocation system. Although there is some potential for misrepresenting sales destinations, the rules used by the states should provide a good basis for accuracy.

FA removes the incentive for profit shifting" to lower tax countries by dividing total worldwide profit to be taxed based on a fairly clearly definable percentage of sales, or other factors, by country. Businesses would not want to reduce sales in the US, regardless of the tax rate. FA also removes the incentive for corporate inversions by taxing both domestic, and foreign corporations that have US tax nexus, on the same percentage of sales basis which should meet WTO standards for equal treatment.

FA removes the need for the US, and also for other nations, to try to "bid down" their corporation tax rates to undercut other countries and encourage profit shifting and asset relocation in their direction. If FA was adopted by other countries, it would also allow them to return their tax rates on MNBs to higher levels without losing revenue due to profit shifting.

FA would not be a "New Tax" that could be blamed on either political party. And FA is inherently border "adjusted". It would remove some or all of the US federal income tax cost from goods sold outside the US, making them more competitive. FA would also not disrupt most state corporate income tax systems, which are generally based on the current federal corporation code with formula allocation of unitary profits just as the federal tax would be.

FA could also eliminate the issue of "trapped" profits, and lost tax revenue from deferral of off-shore profits, if combined with elimination of deferral and forced recognition of prior year foreign subsidiary profits over a 5-year period. FA would give US multinational businesses permanent tax relief on export sales, rather than allowing permanent tax avoidance from MNB profit shifting, if we changed to an actual territorial system. The tax savings for exporting corporations would provide a good offset for ending deferral of taxes on profits.

