

Testimony of Larry Nannis

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**On Behalf of
The National Small Business Association**



Senate Committee on Small Business and Entrepreneurship

Hearing:

“Next Steps for Main Street: Reducing the Regulatory and Administrative Burdens on America’s Small Businesses.”

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Chairwoman Landrieu, Ranking Member Snowe and members of the committee, thank you for the opportunity to testify on ways to reduce the regulatory and administrative burdens placed on America's small businesses. My name is Larry Nannis and I am a Certified Public Accountant (CPA) and partner of Levine, Katz, Nannis + Solomon, PC, which provides financial management and tax advice to entrepreneurial firms, located in Needham, Massachusetts. I also serve as the Chairman of the Board for the National Small Business Association (NSBA).

Small business owners face an overwhelming regulatory burden in complying with Internal Revenue Service (IRS) regulations. We tend to be an easy target since unlike big corporations—which have hordes of accountants, benefits coordinators, attorneys, personnel administrators, etc. at their disposal—small businesses often are at a loss to keep up with, implement, afford, or even understand the overwhelming regulatory and paperwork demands of the federal government.

Approximately 36 percent of NSBA members have fewer than 5 employees—few, if any, of whom is a tax specialist—leaving business owners with no other choice but to hire outside help to keep track of all their additional reporting and filing requirements, which means even more paperwork.

Not only is the burden a heavy one, but it is disproportional as well. According to Small Business Administration (SBA) Office of Advocacy research, the cost of tax compliance for small firms is 67 percent higher than for their larger counterparts. For firms with fewer than twenty employees, the per-employee cost of complying with the tax code is \$1,304.

This data tells us that we have crafted a tax system that is so complex and burdensome that small businesses are spending valuable time and financial resources on record-keeping and outside help to ensure compliance instead of using these resources to invest and grow their business.

As indicated, tax paperwork and compliance are already major expenses for small businesses and now a new form 1099 reporting requirement, signed into law as part of the Patient Protection and Affordable Care Act (PPACA) will only increase these costs. The new filings substantially increase the current requirement by expanding both the types of businesses and transactions considered reportable.

Information Reporting Requirements on Payments to Corporations

An ugly by-product of the health care reform legislation is a “pay-for” requiring businesses that purchase more than \$600 of goods or services from another business to submit two 1099 forms—one to the IRS and one to the service or goods provider. Under past law, service recipients were only required to file 1099 forms for non-corporation service providers. The Department of Treasury has argued that the exemption of corporations under the old system created compliance issues and this new proposal will level the playing field.

However, in practicality, this means that every time a small-business owner ships a package with Federal Express or buys office supplies with Staples, and the expenses total more than \$600 by year-end, they would need to keep the receipts, prepare a form 1099 and file them not only with the IRS, but with Federal Express and any other companies as well. As enacted, every small-business owner—including myself—will face an increased paperwork and administrative burden for each additional 1099 form prepared. In fact, at Levine, Katz, Nannis + Solomon, PC, if the law applied for 2010, we would increase from just two 1099s to more than 79 forms filed.

Increased costs are incurred for mailing additional forms and for hiring outside assistance to ensure that businesses are correctly complying with the law. The new requirements will dramatically increase these costs, as owners will be forced to spend more time collecting the information needed to properly complete these forms, pulling capital out of the business that could be better used to reinvest in the business and create jobs.

Furthermore, if a business previously has not been required to utilize the form 1099 filing system, greater difficulties with compliance is likely to ensue. While the proposal seeks to capture non-compliant corporations, it clearly places the burden on the wrong taxpayer—the compliant small-business.

It must be said—NSBA does not condone the non-payment of tax obligations. The overwhelming majority of small businesses are honest, hard-working organizations that are critical to the economic success of the American economy. Given the extraordinary burden that compliance with the unbelievably complex tax code already imposes on small businesses, it is unfair to ask truthful small businesses to do even more in order to catch a few potential cheats.

Additionally, if allowed to be implemented, Section 9006 of the PPACA will also have a chilling effect on new business relationships, most of which will be small businesses and startups. NSBA members have feared another way businesses may try to avoid the reporting burden is by consolidating all their purchases with a few larger vendors.

Meaning, many businesses in an attempt to reduce data collection and paperwork burdens will simply reduce vendors and refuse to entertain new business dealings. This will have a disproportional impact on small businesses and entrepreneurs attempting to get a foot in the door. Although this could simplify the accounting burden, it would have a devastating competitive impact on small local independent businesses who now sell the same services or products to other businesses.

Another component of the new reporting requirement is an exemption on any payments above \$600 which are made with a credit card. While seemingly a way to ease the burden, this provision stands to harm small businesses in four key ways.

First, this will force small-business owners into using credit cards more frequently for larger purchases, which, given the failure of Congress to protect these cards, could constitute significant new costs for small businesses. Second, it will cause increased

credit-card transactions from customers, which means increased costs in swipe fees for the small-business owner, and in many cases and inability to compete with large on-line retailers. Third, the provision will hamper business-to-business transactions as 47 percent of small businesses do not accept credit cards for the purchase of their goods and/or services. Fourth, small-business customers will look to ease this reporting requirement by consolidating purchases, which gives an inherent advantage to large suppliers over small businesses.

In 2009, according to the July 2010 NSBA Economic Survey, small businesses were required to file 1099 reports on an average of 10 independent contractors. This could change drastically under the new law, however. The new 1099 reporting requirements stand to increase the average number of firms for which small-businesses must file a 1099 report from an average of 10 to an average of 86. Furthermore, small businesses reported that, among those 86 companies with which they spend more than \$600 annually, only 30 percent of those purchases are made with a credit card.

Data Use

Meanwhile, this mandate has nothing to do with health care coverage or reform, but is deemed a way to raise revenue by closing the tax gap—the difference between taxes owed and taxes paid—estimated to be \$345 billion in tax year 2001. This type of reporting, which uses form 1099 to indicate how much money businesses pay to corporations, was an idea proposed by the Bush administration to help better keep track of what businesses spend and earn, which in turn helps better keep track of tax liability. Yet, little data exists to demonstrate that the newly collected information is a source of the tax gap and it is unclear whether and how the IRS can use this paperwork.

Moreover, NSBA is concerned what the IRS will do with this amount of data. We do not believe that the IRS even has the capacity to utilize this data nor does the IRS have the matching capabilities to handle the massive volume of paperwork resulting from this proposal. There is no data available to justify this additional burden—the data does not prove whether business-to-business versus business-to-consumer transactions are the problem, it does not specify if underreporting is more prominent in payments over or under \$600, it does not breakdown the underreporting of income by cash or credit card transactions, and it does not indicate whether some industries are more non-compliant than others. While the concept of significantly increasing taxpayer compliance may appear justifiable, the practical impact of implementing it could be devastating to the individual taxpayer.

Legislation

NSBA has been adamant that the only solution to the huge problem posed by the new 1099 reporting provision is full repeal. As critical a component of our nation's economy as small business is, one has to wonder why Congress continues to harm these budding business-owners. Fortunately, many members of Congress agree that full repeal of this provision is really the only way to fix the problem.

Senator Mike Johanns has stepped up to the plate and offered legislation to fully repeal this reporting requirement. The *Small Business Paperwork Mandate Elimination Act*, which, if passed into law, would repeal the onerous paperwork burdens imposed on business by the ill-conceived expanded information reporting mandate contained in Section 9006 of the PPACA. Companion legislation (*H.R. 5141*) has been introduced in the House by Rep. Dan Lungren.

In September, the Senate shot down two separate amendments to the Small Business Jobs Act that addressed the requirement. The first, again sponsored by Johanns, would have fully repealed this \$17 billion revenue-raising provision. The second, by Sen. Bill Nelson would have scaled back the requirement by repealing the law for all businesses with fewer than 25 employees, and increasing the threshold to \$5,000.

I should also mention that Chairwoman Landrieu has also introduced the *Information Reporting Modernization Act of 2010 (IRMA Act)*, a bill to modernize and simplify the form 1099 reporting requirements in response to NSBA's and others growing concerns about the 2012 reporting requirements. The IRMA Act raises the reporting threshold to \$5,000 for purchases of goods or services paid for with cash or check, as well as adjust the amount annually for inflation. The bill also requires the IRS to upgrade its scanning technology to allow for a free online entry and submission of the 1099 form on its site.

Honestly though, these compromise languages would not do anything to ease the paper trail businesses would be required to maintain, nor would it ease the business consolidations as a result of the new requirement. Again, for my company, if the threshold was raised from \$600 to \$5,000, we would jump from two 1099s filed to approximately 37.

Further Regulatory Burdens

Unfortunately, repealing the form 1099 reporting requirement will not lift the regulatory yolk from the necks of America's small businesses. Perplexing paperwork and an oppressive federal regulatory regime continue to overburden innumerable small-business owners across the country.

SBA research demonstrates that, in total, companies with fewer than 20 employees pay more than \$10,585 per employee to comply with federal regulations each year. Large firms pay about \$7,755—or 36 percent less per employee.

According to Office of Advocacy's "The Impact of Regulatory Costs on Small Firms" report, environmental regulations appear to be the main reason for the disproportionate impact on small firms. Compliance with environmental regulations costs 364 percent more for small firms than large firms. The cost of tax compliance is 206 percent higher for small firms than the cost for large firms.

Despite the efforts of SBA's Office of Advocacy, which reports that its interventions resulted in foregone, first-year regulatory cost savings of \$7 billion in Fiscal Year 2009, the federal regulatory and paperwork burden continues to balloon. SBA estimates that the overall cost of federal regulations in FY09 was \$1.75 trillion.

NSBA Recommendations

The status quo of increasing regulatory and paperwork burden is untenable. The federal regulatory framework is broken. Therefore, NSBA proposes the following solutions:

- *Consider Indirect Economic Impact:* The largest loophole in the federal regulatory framework is that agencies are only required to consider the direct impact of proposed regulations. This must change. The indirect economic impact of proposed regulations also must be considered. Additionally, each Initial Regulatory Flexibility Analysis required under the Regulatory Flexibility Act also should contain detailed alternatives, which would minimize any significant adverse impact.
- *Provide Small-Business Assistance:* Federal agencies must do more to provide compliance assistance, including publishing plain-language compliance guides for small businesses. Agencies must simplify their regulations, instructions, and compliance processes. Helping small businesses comply, rather than punishing those that inadvertently do not, should be the goal.
- *Use Plain Language:* NSBA also urges Congress to ensure the realization of the recently codified Plain Writing Act, which mandates the use of plain language in all federally-written letters, forms, notices, or instructions, especially those that provide facts about federal benefits or services, information on how to obtain those benefits or services, and explanations on how to comply with federal requirements, including taxes. NSBA also encourages Congress to expand this requirement to federal regulations. Publishing clear and comprehensible regulations will increase regulatory compliance. The vast majority of small-business owners strive to adhere to a vast array of federal obligations but many have difficulty deciphering what is being required of them.
- *Increase Agencies' Flexibility and Expand Exemptions:* Federal agencies must be permitted increased enforcement flexibility and the ability to grant common-sense exemptions for first-time offenders.
- *Streamline Paperwork:* Agencies must seek ways to consolidate forms and eliminate the duplication of paperwork, harmonize data, and coordinate due dates.
- *Perform Cost-Benefit Analysis:* Federal agencies should be required to perform and submit cost-benefit analysis on proposed regulations and paperwork. This is a routine business practice that federal agencies would be well-served to emulate.
- *Improve Information Collection:* The Paperwork Reduction Act requirement that agencies' chief information officers review and certify information collection requests is

ineffective. This provision should be strengthened or the Office of Information and Regulatory Affairs should develop stricter criteria for approval. If all else fails, Congress should consider limiting the number of information requests an agency can issue each year. Federal agencies should ensure that their information collections will provide public benefit and utility and eliminate unnecessary requests. Agencies also should expand their ability to accept voluntary electronic information submissions.

- *Fair Tax*: Congress should stop trying to impose more burdens on taxpayers and replace the current tax code altogether with something that makes more economic sense, such as the Fair Tax. A long-time proponent of the Fair Tax, NSBA believe that now, more than ever, a sensible, fair method of collecting taxes is needed—contrary to the current system.

- *Overall Tax Reform*: NSBA believe efforts to reducing the regulatory and administrative burdens on small businesses must focus on overall simplification, eliminating inequities within the tax code, and enhancing taxpayer education and outreach. Perplexed, bothered and bewildered American taxpayers spent \$265 billion in recent years just trying to comply with the tax laws and regulations. Yet, even with this vast expenditure of money, no one—including small-business owners—is sure they successfully complied with the law.

Accurate tax reporting and compliance is extremely important to small business. Those who make a good faith effort, yet are inaccurately complying should be assisted through education and tax simplification efforts. Those willfully disregarding their tax liability should be held accountable. The more assistance offered to taxpayers and the simpler it is to understand and comply with tax laws, the more taxpayers will accurately meet their tax obligations. However, increased enforcement at the expense of taxpayer education will not in the long term accomplish sustained, improved compliance.

Vague rules and poorly defined regulations understandably result in mistakes. In order for taxpayers to comply more easily with the tax laws, taxpayer services should include providing timely guidance on issues, promoting electronic filing of tax returns, explaining IRS notices and correspondence, and helping taxpayers with problems. With the complexity facing many taxpayers, NSBA believes a key priority should be the development and implementation of initiatives to improve IRS guidance.

Conclusion

NSBA concludes that the Committee should work with the IRS to conduct more research to better identify noncompliant taxpayers, enhance taxpayer services to inform taxpayers of correct tax obligations and adjust its enforcement tools to target those who intentionally evade paying taxes. Adding new burdens and requirements on small business already struggling to do the right thing is simply the wrong answer.

It is my hope that Congress and the administration can work together toward a straightforward repeal of the 1099 provision. Now is the time for Congress to support

proposals that are fair and reasonable, and that do not hinder the survival, growth and innovation of our nation's entrepreneurs. I would like to thank Chairwoman Landrieu for holding this hearing, bringing this proposal to the forefront and for the opportunity to testify.