

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

**NFIB**  
The Voice of Small Business.®

Testimony of

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Before the

**U.S. Senate Committee on Small Business and Entrepreneurship**

**Targeted Tax Reform: Solutions to Relieve the Tax Compliance Burdens for  
America's Small Businesses**

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Good morning Chairman Vitter and Ranking Member Shaheen, and members of the Senate Committee on Small Business. I am pleased to be here on behalf of the National Federation of Independent Business (NFIB) as the Committee explores ways to reduce the tax compliance burdens on American small businesses. On behalf of our members, thank you for the opportunity to provide our perspective on this important issue.

NFIB is the nation's leading small business advocacy organization representing over 350,000 small business owners across the country. Our members represent small businesses in every region and every industry across the country. The typical member employs about 8 to 10 employees with annual gross receipts of about \$500,000, with about 80 percent employing less than 40 employees. All members are independently owned, which is to say that none are publicly traded companies. Regardless of trade or industry, our members consistently rank tax-related issues, including tax code complexity and compliance burdens as among the most difficult problems facing in running their businesses.

### **Small Business Outlook**

The small business economy is slowly emerging from one of the worst recessions in U.S. history. NFIB's monthly Small Business Economic Trends (SBET) survey data shows the dramatic change in consumer spending, employment, owner's confidence and business investments throughout the recession and subsequent recovery<sup>[1]</sup>. While some business activities have made significant improvement over the past four years, capital expenditures and the outlook on business conditions and expansion remain at historically low levels due to economic conditions and the political climate. The threat of higher taxes whether in the form of income taxes, the healthcare law, the estate tax, section 179 expensing limits, or others creates enormous uncertainty among small business owners worried about the impact of policy changes on future business costs.

The SBET survey also tracks which problems most affect owners in operating their small businesses. From mid-2008 through mid-2012, "poor sales" was their number one problem as consumer spending had declined sharply. But now "taxes" is often the number one concern for small business owners, a problem that moderates the economic recovery in the small business sector. In fact, tax-related issues compromise five of the top 10 most severe problems for small business owners.<sup>[2]</sup>

However, following a promising string of improvements in owner optimism during the first months of the year, the most recent Small Business Optimism Index showed disappointing signs of economic weakness amongst small business owners. In the June 2015 report the Optimism Index plunged 4.2 points to 94.1, the lowest point of the year so far and the most significant decline since November 2012. The June Index was well below the pre-recession average of 99.5. Small business owners reported that they plan to spend less, and had weaker expectations for sales growth, expansion opportunities, and business conditions in the next six months. The report was a disappointing sign that economic growth on Main Street is not set for a strong

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<sup>[1]</sup> Dunkelberg, William C., and Holly Wade, *NFIB Small Business Economic Trends*, NFIB Research Foundation, series.

<sup>[2]</sup> Holly Wade, *Small Business Problems and Priorities*, NFIB Research Foundation. Washington, DC, series.

second half of growth. The weakness was substantial across the board, showing no signs of a growth spurt in the near future.

## **Small Business Tax Concerns**

### *Complexity in the Tax Code*

Unlike their larger counterparts, the typical small business does not employ an in-house accountant or tax lawyer. For this reason, the complicated and unpredictable tax code, places a greater burden on small business owners. The burdens from tax compliance take money and time away from the day-to-day business operations or investing in and expanding their business. Small business owners must then absorb these costs, just like any other into their bottom line or pass them on to the customer in the form of higher prices.

The NFIB Small Business Problems and Priorities survey highlights three main areas of tax policy that are of great concern to small business owners<sup>1</sup>. The survey is a random sample of NFIB members asking them to evaluate 75 potential small business problems and assess the severity of each. The problems are then ranked by their mean score. According to our latest survey five of the top 10 problems are tax-related. These tax problems fall into three categories: cost, complexity and frequent changes.

The cost of tax obligations includes the amount paid to federal, state and local tax agencies, the cost of hiring a CPA or tax advisor to navigate complex tax codes, and the owner's time in providing the required paperwork and/or filing themselves. Eighty-eight percent of small employers use a tax preparer, and most use one to either ensure compliance or because the requirements are too complex. Tax-related regulations cause the greatest difficulties for 40 percent of small employers, more than environmental, health and safety, or employee-related regulations.<sup>2</sup> And compliance costs are especially problematic for small business owners as they are 67 percent higher for small businesses than for their larger counterparts, costing them \$18-19 billion per year, or about \$74 per hour<sup>3</sup>.

Tax-related costs compete with owners' time and ability to use limited profits for the core business activities. For owners, retained earnings are the primary funding source for purchasing new equipment, expanding, hiring and stocking inventory. It is their safety net during the inevitable periods of slow sales or other problems that can befall a small business. For businesses just starting out, tax-related costs are especially problematic because these businesses must almost exclusively rely on profits for operation and are generally not able to access traditional lending sources. Banks traditionally lend to more established firms that they know will be around to repay their debts, and not newer ones due to higher failure rates. However, regardless of the firm's age, tax burdens take a heavy toll on owners' ability to operate their businesses.

The federal tax code is only one layer of tax obligations owners face in operating their business. They must also comply with state and local taxes adding to the overall compliance burden. Unfortunately, only the owner experiences the cumulative effect of all the required taxes and

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<sup>1</sup> Wade, Holly, *Small Business Problems and Priorities*, NFIB Research Foundation, 2012.

<sup>2</sup> Dennis, William J., *Tax Complexity and the IRS*, NFIB Research Foundation, Volume 6, Issue 6, 2006.

<sup>3</sup> <https://www.sba.gov/sites/default/files/advocacy/rs343.pdf>

regulations places on their business. Federal, state and local lawmakers and government agencies only see them in isolation, giving a false perception of their true impact. But it's the responsibility of the business owner to manage them all while trying to operate a profitable, successful business.

Taking prudent steps toward reducing complexity and uncertainty in the tax code will help to promote smart business planning, increase compliance, while also reducing the burdens on small businesses. In the end, this is a win for business owners, employees, our economy and even the IRS.

### *Expensing*

The tax code and accompanying tangible property regulations ("Repair Regulations"), determine when a business may deduct the costs for acquiring, repairing and replacing business property as an ordinary and necessary business expense, and when they must capitalize and depreciate that expense over a number of years. At more than 200 pages, the regulations are dense and difficult. For even the seasoned tax professional, trying to make sense of the regulations often results in at best an educated guess. For a small business owner, a simple decision of whether to repair, replace or upgrade a piece of business equipment requires performing a daunting and incomprehensible multi-step facts and circumstances analysis.

A common decision such as should the business pay to repair a broken refrigerator or air conditioner or buy a new replacement unit is no longer a pure business decision once tax considerations are included. The Repair Regulations require the owner, or pay their accountant to determine how many shingles can be replaced on their roof before that repair has become an "improvement," and those costs can no longer be immediately deducted. Similar questions arise for the business owner wanting to replace a window with a more energy efficient model or install safer systems for fire suppression or security. This inherent complexity for even the smallest purchases can force a small business owner to delay or cancel otherwise necessary, smart investments in their business and can lead disputes with the Internal Revenue Service (IRS).

Recognizing this complexity burden, recent Treasury regulations included a business-friendly safe harbor for small-dollar equipment purchases. Specifically, Treasury Reg. §1.263(a)-1(f) provides a de minimis safe harbor election that would generally allow a business to deduct certain equipment purchases and repairs based on a dollar threshold. However, the safe harbor election currently sets two threshold amounts: \$500 for taxpayers without an applicable financial statement (AFS) and \$5,000 for taxpayers with an AFS. Examples of an AFS include a financial statement required to be filed with the Securities and Exchange Commission (SEC) (the 10-K or the Annual Statement to Shareholders); and a certified audited financial statement that is accompanied by the report of an independent certified public accountant that is used for a substantial non-tax purpose. However, as most small businesses do have an AFS, the \$500 threshold is set too low to achieve its intended purpose.

The current \$500 threshold simply does not reflect the current small business environment and would fail to cover many standard repairs or common equipment purchases. The low threshold also discriminates against small business owners without an AFS. For example, while a larger business with an AFS could immediately deduct a \$1,500 computer purchase or the cost to replace an air conditioner condenser, their small business competitor might be forced to

capitalize and deduct the same cost over a number of years. A meaningful increase the safe harbor is even more important given the constant expiration and extension of Sec. 179, small business expensing.

### *Sec. 179 Permanency*

Making the current Sec. 179 expensing thresholds permanent would greatly reduce the complexity of the code. Instead of following complicated depreciation schedules and keeping the paperwork associated with the investment, the business owner can simply claim the deduction in the year the item is purchased. As Congress considers specific issues in the code, making the higher Section 179 amounts permanent would go a long way to reducing complexity and providing an important tax benefit to small business owners. Since 2003, Congress has wisely increased the allowable expensing amount from \$25,000 to \$500,000. Additionally, Congress expanded Section 179 expensing to include real property with the passage of the *Small Business Jobs Act*.<sup>4</sup>

When considering the stress of our members on the topic of expensing the cost of long-lived assets, making the law permanent and eliminating the roller coaster of the maximum deduction would ease their minds considerably. Without knowing what their tax liability will be at the end of this year, business planning becomes very difficult for our nation's number one job creators.

### *Cash Receipts and Disbursements (Cash Method)*

Expanding the availability of the cash method of accounting is another example of where Congress could act to provide simplification in the tax code. Under the cash method, income is generally recognized when actually or constructively received, and expenses are deductible when paid. The cash method is comparatively easier to use, practical to administer and more closely matches the way that a small business owner will keep his books. Importantly, it provides for the payment of tax at the time when the taxpayer is most likely to have the ability to pay.

Rather, under an accrual accounting method, income is recorded when a sale is made, even if the business does not receive the payment right away. Accrual method accounting is not based on cash flow but based on fixed rights to receive payment, and is subject to complex statutory and regulatory rules. The timing mismatch between income inclusion and actual receipt of the payment can create cash flow issues for a small business owner. Since the cash method only records revenues and expenses when they are paid or received, a business owner will have a better sense of how much cash they have on hand at any particular moment.

However, under the current law, certain taxpayers with greater than \$5 million in gross receipts are not able to use cash accounting, and rather must use an accrual accounting method. Allowing any business entity with revenues less than \$10 million to use cash basis accounting, as long as the cost inventories are not deducted until sold, would be a small but important change that would benefit small businesses.

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<sup>4</sup> P.L. 111-240

## **Conclusion**

Small businesses truly are the engine of economic growth. This isn't just a slogan, as small businesses created two-thirds of the net new jobs over the last decade. Small business owners are risk takers and entrepreneurs. They are the last businesses to lay off employees when business declines and slow to rehire when business picks up. When small business hires an employee, it is their intent to keep them on for the long run.

However, the current tax code has become a confusing and unpredictable challenge for the vast majority of small business owners. Small business owners continue to be excessively burdened by direct, indirect, complicated and ever changing taxes related to operating their business. Alleviating the excessive tax burden on small businesses is an essential component in creating a strong, healthy environment for owners to operate and grow their business.

I appreciate the opportunity to present NFIB's views on the effects of tax policies on small businesses. I appreciate that the Committee is taking a serious look at the tax code challenges facing small businesses and urge you to keep in mind the unique challenges that face small businesses going forward. I look forward to answering any questions you might have.