Comments Provided to the

Small Business/Pass-Throughs Tax Reform Working Group

by the

Computing Technology Industry Association (CompTIA)

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Tax Reforms for the IT Industry

Overview

Tax burdens and compliance costs consistently force small and medium-sized (SMB) information technology (IT) companies to divert needed resources away from their core businesses, restricting growth and innovation. Reducing the financial burden on these firms via tax reform would promote additional growth and opportunities for the SMB IT industry, and eliminate hurdles within the tax code that are limiting the industry's ability to remain globally competitive.

While the SMB IT industry strongly supports closing unfair loopholes and outdated deductions as a means of increasing revenue for broader reforms, there are several key tax provisions that incentivize growth and innovation. Removing these provisions would significantly hamstring SMB IT's ability to grow and strengthen the economy.

The comments provided herein provides an overview of the industry and highlights the key tax policies for the IT industry within four tax reform principles:

1. Simplify the tax code.
2. Reduce the tax burden on the SMB IT industry.
3. Incentivize growth and innovation.
4. Protect SMB IT from new interstate tax compliance burdens.

The data compiled for this report are largely the result of an annual survey CompTIA conducts of its members.

A Vital Contributor to the Economy

The IT industry in the United States remains a vital contributor to the domestic economy. Currently, the industry comprises about 26 percent (or $950 billion) of the $3.6 trillion global industry. Through innovation and growth, domestic IT firms have remained globally competitive and economically strong. SMBs within the IT industry employ some 1.8 million workers, while spending approximately $110 billion annually on payroll. Generally, these are high-paying jobs that rely on skilled workers who continually adjust their skills to meet market trends.

Moreover, within this category, many companies operate within what is referred to as the IT channel. The IT channel spans the IT marketplace between the vendor and the end-user and forms a bridge between distributors, resellers, integrators and consultants. Seventy-five percent of all IT products and services, representing more than $350 billion, are sold to businesses through the channel as opposed to through retailers or direct sales. The vast majority of IT firms in the channel are small and medium-sized enterprises.

Although the industry remains strong, there is significant potential for additional growth. According to January 2013 statistics from Indeed.com, more than 265,000 IT-related jobs are currently available. While this reflects a clear skills gap among potential employees, it also highlights the current job growth in IT firms.

While a range of policies may impact the state of the industry, few have a larger impact than the current tax code. Despite good intentions, too many outdated or unfair policies have proven to hamstring growth within the industry. Given the impact that SMB IT business has on the economy, ensuring the tax code promotes growth for domestic IT should be a key goal in any tax reform efforts.

Principle 1: Simplify the Tax Code

The tax code has continued to become increasingly complex and complicated, especially for SMB IT companies that do not have the resources to maintain large internal accounting and legal departments. As the tax code has grown, the cost of compliance (and potential for mistakes) has increased rapidly. Both sides of the political aisle have identified the need to simplify the tax code as a key priority.

A recent CompTIA survey found that 48 percent of IT executives identify complexity and the burdens associated with managing taxes as their primary concern with U.S. tax policy. Further, the survey found payroll tax filings to be the most costly and complicated tax requirements for businesses.

CompTIA recommends the following:

- **Payroll Tax Filing Simplification:** Employers are generally required to file Form 941 on a quarterly basis to report and pay federal income tax withholdings, social security and Medicare tax. Very small employers with an annual liability of $1,000 or less are allowed to replace these quarterly filings with a single annual Form 944. Increasing this $1,000 threshold would allow more small businesses to file annually instead of quarterly, which would significantly reduce the cost of compliance and risk of error. CompTIA recommends increasing this annual threshold to $50,000, which will provide compliance burden relief for the majority of the 5.8 million[1] small businesses employing 1-99 employees.

[1] *According to the 2008 U.S. Census, there were a total of 5,821,277 small businesses employing approximately 42 million employees with an annual payroll of over $1.5 trillion.*

Principle 2: Reduce the Tax Burden on the SMB IT Industry

According to the U.S. Economic Census, 67 percent of IT services firms, including employer and non-employer businesses, pay taxes at individual rates as a sole proprietor or pass-through entity. Therefore, it is important that tax reform does not adversely affect these small businesses. While a corporate tax rate reduction remains very popular among SMB IT companies (63 percent believe it would be an important policy), the direct impact to pass-through entities would be tangential. However, the economic implications of a corporate tax rate reduction (and its impact on adjacent industries) would likely have a positive impact on SMB IT companies depending on the broader tax policies adopted.

Within comprehensive tax reform, a variety of tax provisions, including a corporate tax rate reduction, will be on the table. While the IT industry may be impacted to varying degrees depending on the combination of the various reductions, it is important that any solution provide comparable rate reduction for entities that are sole proprietors and pass-through entities. Ignoring these important economic engines – by simply reducing the corporate tax rate alone – would continue to hamstring the ability of the SMB IT to grow and prosper. We also recommend a reduction in the employer's share of payroll taxes; this will encourage businesses to hire more workers, which will in turn lead to economic growth for our nation.

Principle 3: Incentivize Growth and Innovation

The SMB IT industry relies on its ability to grow and remain innovative. Many of the largest IT companies in the U.S. started as small businesses that succeeded through constant innovation and investment. Unfortunately, many of these small start-up IT firms are economically unable to continue to make these innovation investments.

The SMB IT industry believes the tax reform debate must include discussion of all tax provisions. However, certain tax provisions are meaningful to economic growth and provide a pathway to innovation for the SMB IT industry.

CompTIA recommends the following:

- **R&E Tax Credit for Small Businesses:** Most small start-up companies do not show a profit, and thus do not have an income tax liability against which to offset the traditional R&E tax credit. Therefore, some of the most vital and innovative companies cannot receive any economic benefit from the traditional R&E tax credit. Accordingly, CompTIA supports legislation that would allow start-up companies to offset a simplified R&E tax credit against payroll tax liability.

- **Bonus Depreciation:** Bonus depreciation promotes investment and growth by businesses and has been especially important to small businesses. While the economy shows signs of improvement, small businesses need continuing support to grow their businesses. For 2011 and 2012, businesses were allowed an additional 100 percent bonus depreciation. This limitation has been extended through 2013, but will expire beginning in 2014. CompTIA calls on Congress to permanently extend bonus depreciation at the 100-percent level.

- **Small Business Expensing:** Section 179 allows small businesses to deduct the cost of certain asset purchases, as opposed to requiring the cost to be capitalized and depreciated over a period of years. This enables small businesses to invest in technologies that improve both productivity and the quality of goods and services. The current limitation of $500,000 per year will drop to $25,000 after 2013. CompTIA strongly supports a permanent extension of the $500,000 limitation.

Principle 4: Protect SMB IT from New Interstate Tax Compliance Burdens

As state budgets face ever-increasing pressures to raise revenues, state tax authorities must become more creative in their collection efforts. While states should not be limited in their ability to tax transactions within their jurisdiction, it is important that this emerging regime of taxation not unfairly impact the IT and tech industries, especially SMBs. Additionally, it is important that new state tax laws do not create unfair and duplicative taxes on SMB IT companies, imposing additional compliance costs on sellers and their customers. Therefore, CompTIA recommends:

- **Small Business Exemption for Sales and Use Taxes:** For any legislation that would require out-of-state sellers to collect and remit sales taxes, CompTIA supports a robust small business exemption. Small businesses are less capable of bearing the costs of a new tax compliance requirement. CompTIA believes the debate should be refocused to balance the rights of states to collect sales taxes with the ability of small businesses to cover these new compliance costs. States have a right to collect sales and use taxes owed, but the costs associated with shifting this compliance burden onto small businesses also must be weighed. Small businesses that provide goods and services remotely are as vital to our economy as those small businesses that reside in and make sales within a single state.

- **Digital Download Taxation:** Consumers, vendors and taxing authorities need a consistent rule to determine which state/ jurisdiction is permitted to impose a tax on the purchase of a digital product or service. Currently, there is no certainty concerning which jurisdiction has the authority to tax these products among the location of the customer, seller's server and customer's home address. This creates the potential for multiple and discriminatory taxes on the purchase of digital goods and services. Therefore, CompTIA supports proposals that would restrict collection of sales taxes on digital goods and services to the jurisdiction encompassing the consumer's tax address, while also prohibiting multiple and discriminatory taxes. We believe this is a simple and objective criterion that will bring both certainty and lower compliance costs for taxpayers, vendors and taxing authorities.

- **Business Activity Taxation:** While physical nexus (having an office or place of business in the state, or employing workers that operate within the state) continues to control sales and use tax collections, some states now are seeking to tax any transaction that has an "economic nexus" to that state. CompTIA supports enactment of a distinct physical presence requirement as a prerequisite for the taxation of business activities. That is, states should not be permitted to tax businesses that do not have a physical presence or workforce within that state. Permitting states to reach out to impose tax collections and reporting on non-resident small businesses that have no contact with that state would impose an unaffordable compliance burden, especially on the SMB IT industry.

Conclusion

The strength of the IT industry relies on its ability to grow, innovate and adjust to market trends. SMB IT companies across the nation are providing services to all major industries from healthcare to agriculture. The success of these industries relies on the IT industry and the services they provide.

The U.S. IT industry continues to add jobs and strengthen the economy. Additionally, we are remaining competitive in a rapidly evolving global marketplace. While the industry remains strong, we must continually identify ways to mitigate the burdens on these companies in an effort to increase their growth potential, which translates into sustaining and generating high-paying jobs.

Therefore, tax reform should be a mechanism to promote additional growth and opportunity for the SMB IT industry and eliminate hurdles within the tax code that are limiting the industry's ability to remain globally competitive.