Testimony of Frank Knapp, Jr.
President and CEO, South Carolina Small Business Chamber of Commerce
Submitted to
House Ways & Means Committee
Hearing on Corporate Tax Reform and Job Creation

June 2, 2011

My name is Frank Knapp, Jr. and I am President and CEO of the South Carolina Small Business Chamber of Commerce, which has more than 5,000 small business members in the State of South Carolina. I am also a member of Business for Shared Prosperity. Both the South Carolina Small Business Chamber of Commerce and Business for Shared Prosperity are members of the American Sustainable Business Council (ASBC). ASBC is a network of 30 small business organizations with more than 100,000 independent small business members.

I appreciate the opportunity to present this testimony on behalf of these three organizations on the subject of corporate tax reform and job creation.

While small businesses are often portrayed as significant supporters of corporate tax cuts, our members take a different view. We know that tax cuts must be paid for by cuts to spending, and have recently witnessed Congress's attempt to deal with the fiscal crisis by cutting programs that help our communities and our customers. These cuts have hurt our businesses.

Cutting Taxes Does Not Create Jobs

As small businesses, few of us have ever created a job because we got a tax break for doing so. We hire people when there is demand for our goods and services. The success of our businesses is dependent on economically healthy communities and strong customers. The lingering recession has left many of our communities suffering and weak. When Congress reduces aid to states, or slashes community development block grants that provide jobs in our communities, our businesses feel that. It stifles our ability to create jobs.

Corporate taxes, like individual income taxes, support the public services and infrastructure upon which all businesses depend. These include a publicly educated workforce, transportation systems, safe drinking water and sanitation, the judicial system, taxpayer-funded research (which has played a crucial role in health advances and the creation of the Internet, for example), federal emergency response and so on. But, the public services and infrastructure underpinning a healthy economy are now being cut dramatically because of inadequate revenues. This impedes both U.S. business competitiveness and job creation.

We believe the combination of the tax cuts of the last decade, coupled with underinvestment in infrastructure and innovation, has led to the stagnant economy we experience today. As *The Wall Street Journal* reported, President Bush "shows the worst track record for job creation since the government began keeping records" in 1939. The Bush administration created just 1.1 million net jobs, while the Clinton administration created 22.7 million. In the six years after Clinton's 1993 tax increase, employment grew 16.2 percent compared to just 4.8 percent in the six years between Bush's 2001 tax cut and the Great Recession. The 2001-2007 economic expansion was the weakest since World War II when it came to growth in GDP, consumption, non-residential investment, wages and salary, and net worth, as well as employment growth. And the meltdown following was the worst since the Great Depression.

We Agree Corporate Tax Reform Is Needed

While the small business organizations I represent do not agree that corporate tax reform focused on reducing corporate rates would lead to job creation, we are in full agreement that corporate tax reform is necessary.

Our corporate tax system is badly broken. The current tax system creates an unlevel playing field between multinational and domestic businesses and between large businesses and smaller ones. Some corporations are paying a full share of taxes, while other equally profitable companies pay nothing at all. Too many corporations have turned their tax departments into profit centers, mining existing loopholes and lobbying hard for new ones. All of this has left corporate income taxes as a share of federal government receipts at historically low levels. In the 1950s corporate taxes made up a third of federal government revenues; today corporate taxes contribute less than a tenth of what the federal government takes in. The result of this tax shift is that while major corporations have seen their share of the tax burden dramatically shrink, small business owners and the middle class have picked up the slack. In effect, small businesses are subsidizing their economically dominant peers.

Rather than having the corporate tax debate focus on the statutory rate paid by corporations; we believe the debate should center on the appropriate share of the costs of government that should be borne by corporations.

Tax Holidays Proposed in Recent Legislation Will Only Lead to More Abuse and Continued Unfairness

We oppose both short and long-term tax holidays, in the form of a one-time tax holiday on repatriated foreign earnings, or in the longer-term adoption of a territorial tax system which would exempt all foreign income from US taxes. This year, the U.S. Treasury will lose $100 billion from the abuse of foreign tax havens, as companies use legal accounting tricks, to shift domestic income and repackage it as foreign earnings, upon which taxes are indefinitely

deferred. Following the 2004 tax holiday on repatriated earnings, we witnessed over seven short years a near tripling of the amount of foreign earnings held by large corporation. Moving to a territorial tax system would be like a shot of steroids and this tax avoiding behavior would explode. We fear that putting a territorial tax system in place would further entrench a two-tier tax system in which large multinationals shift their profits offshore and pay little in U.S. corporate income taxes, while domestic manufacturers and those who invest in this country, including the vast majority of small businesses, would be penalized by having to pay a full share of taxes.

Rather than adopting a territorial tax system, we favor Congress reforming the corporate tax system, by closing tax haven loopholes that have undermined the corporate tax system, rendering it ineffective and inequitable. In this regard we support measures like the Stop Tax Haven Abuse Act, introduced in the last Congress, and expected to be reintroduced in the near future. We remember the tax reforms of 1980s in which corporate tax loopholes were closed, rates lowered and still more revenue from corporate taxes flowed into federal coffers. This should be the objective of the corporate tax reform Congress is presently considering.

Finally, we object to efforts to use small businesses such as ours as the reason for extending and deepening reductions in the top individual income tax rates. The false claim is that it would keep small business owners from being adversely impacted should corporate tax reform limit the tax expenditure deductions for flow-through businesses like ours. But the fact is that less than 3 percent of tax filers with any business income make over $200,000 (individuals) or $250,000 (couples) a year, and many of those are not small business owners, much less small business owner operators with employees. They include K Street lobbyists, Wall Street investment partners, big business CEOs paid to sit on the boards of other big companies, wealthy people renting out their vacation homes when they aren't using them and even President Obama, who earns book royalties. Reducing top individual income tax rates would not benefit the overwhelming majority of small business owners who do not pay at the highest rates. In fact, since we would also lose the tax expenditure deductions we presently enjoy, many of us will end up paying more in taxes, while our larger brethren pay far less.

In conclusion I wish the Committee to be aware of the following sign-on letter posted on the Business for Shared Prosperity website (www.businessforsharedprosperity.org), which outlines many of the positions I have just discussed. I ask that the letter reprinted below be included in the written record of the hearing.

Thank you.

Small Business Letter on Corporate Tax Reform

June 2, 2011

Dear President Obama and Secretary Geithner,

We, the undersigned business organizations, like most Americans, want a tax system that is fair and provides sufficient revenue for the public services and infrastructure that underpin our economy. When powerful large U.S. corporations avoid their fair share of taxes, they undermine U.S. competitiveness, contribute to the national debt and shift more of the tax burden to domestic businesses, especially small businesses that create most of the new jobs. We believe corporate tax reform should be guided by three principles:

First, all businesses – large and small – should contribute fairly toward the costs of government and the well being of the economy. U.S. corporate income taxes comprise just 1.3% of GDP, among the lowest levels among OECD countries. The average *effective* tax rate paid by U.S. corporations is half the statutory rate and is low by international standards. The corporate tax share of federal government receipts has dropped from 32% in 1952 to 9% now.

Our nation cannot afford corporate tax reform that is revenue neutral. This would leave corporate taxes as a share of our economy at current low levels. It would deprive government of the resources necessary to provide the services and infrastructure that underpin our economy and our global competitiveness. The Tax Reform Act of 1986 lowered the statutory corporate tax rate but closed so many loopholes it increased corporate tax revenues. At this time of large government deficits, deepening budget cutbacks and deteriorating infrastructure, corporate tax reform should again be revenue positive today.

Second, businesses should not be rewarded for shifting jobs and investment overseas or disguising U.S. profits as foreign profits to reduce their taxes. At present, we have a two-tier corporate tax system, in which some profitable businesses pay 35% of their income in taxes, while other profitable businesses pay nothing at all. Too many corporations have turned their tax departments into profit centers, creating strategies that shift jobs and investment abroad and practicing aggressive accounting manipulation to disguise U.S. profits as foreign profits. This is done for the express purpose of avoiding tax payments. For example, as Bloomberg BusinessWeek reported, "Google reduced its income taxes by $3.1 billion over three years by shifting income to Ireland, then the Netherlands, and ultimately to Bermuda."

Now we find Google and other corporate tax avoiders demanding a tax holiday in order to repatriate the funds they shifted offshore to avoid paying taxes. This proposed repatriation would cost the U.S. Treasury $80 billion according to the congressional Joint Committee on Taxation and increase pressure to cut government spending on services that our businesses depend on. As business organizations, we oppose a tax holiday on repatriated dividends from

foreign subsidiaries. We also oppose any shift to a territorial tax system, which would accelerate aggressive transfer pricing and shifts of domestic profits overseas, permanently rewarding those who seek to avoid their taxpaying responsibilities. Instead, we need to stop this irresponsible tax avoidance, which undermines the U.S. economy, and assure that all businesses play by the same tax rules.

Third, by ending unproductive tax loopholes and subsidies benefiting large corporations, we can level the playing field and raise revenues needed to restore economic vitality. Corporate taxes, like individual income taxes, support the public services and infrastructure upon which all businesses depend. These include a publicly-educated workforce, transportation systems, safe drinking water and sanitation, the judicial system, taxpayer-funded research (which has played a crucial role in health advances and the creation of the Internet, for example), federal emergency response and so on. But the vital public services and infrastructure that underpin a healthy economy are now being cut dramatically because of inadequate revenues.

A transparent corporate tax system that assures all companies pay for the services upon which our businesses, our customers, our workforce and our communities depend, would help restore the economic vitality and domestic job creation we all seek.

Sincerely,

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